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IN THE
Supreme Court of the United States
OCTOBER TERM, 1988

SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY, SOUTH CENTRAL BELL TELEPHONE COMPANY, PACIFIC BELL, NEVADA BELL, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY OF MARYLAND, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY OF VIRGINIA, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY OF WEST VIRGINIA, THE BELL TELEPHONE COMPANY OF PENNSYLVANIA, NEW JERSEY BELL TELEPHONE COMPANY, THE DIAMOND STATE TELEPHONE COMPANY, AND SOUTHWESTERN BELL TELEPHONE COMPANY,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,
Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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QUESTION PRESENTED

In early 1976, the Federal Communications Commission prescribed a 9.5 percent rate of return for the Bell System's interstate services, plus another .5 percent as an efficiency incentive. This required AT&T to design rates for the Bell System that, based on AT&T's best estimates of future costs and market conditions, would most likely produce actual future returns within the FCC's prescription. AT&T filed rates in 1976 that then produced actual returns of 9.25 and 9.59 percent in 1976 and 1977, respectively, and 10.22 percent in 1978.

Six years later, in 1984, the FCC determined that the 1978 earnings were excessive and required AT&T and telephone companies then recently divested from AT&T to refund the 1978 overage retroactively. The refund was to be effected by requiring the carriers to reduce their current rates below levels that were otherwise authorized by the FCC. The FCC refused to allow the carriers to be made whole for the shortfall in 1976. After arguments by petitioners here that the pertinent provisions of the Communications Act are designed to preclude retroactive rate adjustments and that numerous cases in this Court and the Courts of Appeals reject such adjustments under parallel federal regulatory statutes, the District of Columbia Circuit, in a split decision, affirmed the FCC's action as within its statutory power.

Against this background, the question presented is:

> **Whether the FCC's 1984 order to reduce current rates to effect a refund of 1978 earnings constitutes retroactive ratemaking in violation of the specific provisions of the Communications Act of 1934.**

RULE 28.1 LISTING

Southern Bell Telephone and Telegraph Company, South Central Bell Telephone Company and BellSouth Capital Funding Corporation are wholly owned subsidiaries of BellSouth Corporation which have outstanding publicly owned securities. BellSouth Corporation partially owns Air Call Communications Ltd., which is also partially owned by Air Call PLC, a company whose securities are publicly traded in the United Kingdom. BellSouth is in the process of acquiring Mobile Communications Company of America, a company which has outstanding publicly owned securities.

The parent company of Pacific Bell and Nevada Bell is Pacific Telesis Group. PacTel Products and Athens Cellular, Inc. are the only non-wholly owned subsidiaries or affiliates of those corporations.

The Bell Telephone Company of Pennsylvania, The Chesapeake and Potomac Telephone Company, The Chesapeake and Potomac Telephone Company of Maryland, The Chesapeake and Potomac Telephone Company of Virginia, The Chesapeake and Potomac Telephone Company of West Virginia, Diamond State Telephone Company and New Jersey Bell Telephone Company are subsidiaries of Bell Atlantic Corporation. Bell Atlantic does not have a parent company. Its subsidiaries and affiliates (other than wholly owned subsidiaries) are Bell Atlantic Directory Graphics, Inc., and two partnerships: the Chesapeake Directory Sales Company and Bell Atlantic Vehicular Leasing. In addition, Bell Atlantic Mobile Systems, Inc., Bell Atlantic's cellular subsidiary, participates in several limited partnerships which provide cellular service in various metropolitan areas. Bell Atlantic Properties, Inc., Bell Atlantic's real estate subsidiary, is also involved in several real estate development partnerships. None of these partnerships has securities outstanding to the general public.

The parent company of Southwestern Bell Telephone Company is Southwestern Bell Corporation. Gulf Printing Company is also a subsidiary of the parent and is the only non-wholly owned subsidiary or affiliate of either corporation.*

* Additional parties to the proceeding below not joining in this Petition were American Telephone & Telegraph Co., Ameritech Operating Companies, GTE Service Corp., MCI (formerly Satellite Business Systems), Mountain States Telephone & Telegraph Co., National Telephone Cooperative Association, New England Telephone & Telegraph Co., New York Telephone Co., Northwestern Bell Telephone Co., Organization for the Protection and Advancement of Small Telephone Companies, Pacific Northwest Bell Telephone Co., Telecommunications Research & Action Center, and United States Telephone Association.

TABLE OF CONTENTS

	Page
QUESTION PRESENTED	i
RULE 28.1 LISTING	ii
TABLE OF AUTHORITIES	vi
OPINIONS BELOW	2
JURISDICTION	2
STATUTORY PROVISIONS	2
STATEMENT OF THE CASE	2
REASONS FOR GRANTING THE WRIT	9
I. The Court Below Decided a Novel Question Fundamental to Rate Regulation Under the Communications Act in a Manner Contrary to the Act	9
II. The Decision of the Court Below Is in Conflict with the Decisions of this Court and Other Decisions of the Courts of Appeals	13
CONCLUSION	18

TABLE OF AUTHORITIES

CASES: Page

American Public Gas Ass'n v. FPC, 567 F.2d 1016 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978) 9
American Telephone & Telegraph Co. v. FCC, 836 F.2d 1386 (D.C. Cir. 1988) 7, 8
American Telephone & Telegraph Co. v. FCC, 487 F.2d 865 (2d Cir. 1973) 11, 13, 16
Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Ry., 284 U.S. 370 (1932) 4
Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571 (1981) 13, 15
Ashland Coal & Ice Co. v. United States, 61 F. Supp. 708 (E.D. Va.), *aff'd per curiam*, 325 U.S. 840 (1945) 5
Atlantic Refining Co. v. Public Service Comm'n, 360 U.S. 378 (1959) 14
Board of Public Utility Comm'rs v. New York Telephone Co., 271 U.S. 23 (1926) 10
Board of Trade v. United States, 314 U.S. 534 (1942) 5
Boston Edison Co. v. FERC, 856 F.2d 361 (1st Cir. 1988) 15
Colorado Interstate Gas Co. v. FERC, 791 F.2d 803 (10th Cir. 1986) 14
Distrigas Corp. v. FERC, 737 F.2d 1208, *vacated*, 751 F.2d 20 (1st Cir. 1984) 5
Distrigas Corp. v. FERC, 751 F.2d 20 (1st Cir. 1984) 5, 10
Dorchester Gas Producing Co. v. FERC, 848 F.2d 634 (5th Cir. 1988) 14
Electrical District No. 1 v. FERC, 774 F.2d 490 (D.C. Cir. 1985) 16
FPC v. Sierra Pacific Power Co., 350 U.S. 348 (1956) 15
Gulf States Utilities Co. v. Alabama Power Co., 824 F.2d 1465, 1471, *modified*, 831 F.2d 557 (5th Cir. 1987) 15
ICC v. American Trucking Ass'ns, 467 U.S. 354 (1984) 16

TABLE OF AUTHORITIES—Continued

Page

Las Cruces TV Cable v. FCC, 645 F.2d 1041 (D.C. Cir. 1981) 13
Massachusetts v. United States, 729 F.2d 886 (1st Cir. 1984) 15
Nader v. FCC, 520 F.2d 182 (D.C. Cir. 1975) 5, 10
Sea Robin Pipeline Co. v. FERC, 795 F.2d 182 (D.C. Cir. 1986) 15
Transcontinental & Western Air, Inc. v. CAB, 336 U.S. 601 (1949) 10
United States v. SCRAP, 412 U.S. 669 (1973) 11

ADMINISTRATIVE DECISIONS:

Report and Order, *Amendment of Part 65*, CC Docket No. 86-127, FCC 86-514 (released Dec. 3, 1986) 17
American Telephone & Telegraph Co., 58 F.C.C.2d 1 (1976) 6
American Telephone & Telegraph Co., 73 F.C.C.2d 689 (1979) 11
American Telephone & Telegraph Co., 78 F.C.C.2d 661 (1980) 11
American Telephone & Telegraph Co., 86 F.C.C.2d 221 (1981), *aff'd, United States v. FCC*, 707 F.2d 610 (D.C. Cir. 1983) 11
Decision, *AT&T Earnings on Interstate and Foreign Services During 1978*, CC Docket No. 79-187, FCC 84-567, 102 F.C.C. 2d 52 (1984) 6, 7, 16
Memorandum Opinion and Order, *Annual 1988 Access Tariff Filings*, CC Docket No. 88-1, Phase I, 3 F.C.C. Rcd 2043 (1988) 8
Memorandum Opinion and Order, *Annual 1988 Access Tariff Filings*, FCC Docket No. 88-1, Phase II, FCC 88-420 (released Dec. 27, 1988) 8
AT&T Charges for Interstate Telephone Service, Docket No. 20376, 57 F.C.C.2d 960 (1976) 4, 5

TABLE OF AUTHORITIES—Continued

STATUTES & REGULATIONS: Page

Communications Act of 1934

47 U.S.C. § 4 (i) 6, 8, 16, 17
47 U.S.C. § 203 ..... 3, 13, 16
47 U.S.C. § 204 ..... *passim*
47 U.S.C. § 205 ..... *passim*

Natural Gas Act

15 U.S.C. §§ 717c-717d 13

Federal Power Act

16 U.S.C. §§ 824d-824e 13

Interstate Commerce Act

49 U.S.C. § 10704 16
49 U.S.C. § 10708 16
49 U.S.C. § 10762 16

41 Stat. 456 (1920) 12
48 Stat. 220 (1933) 12

MISCELLANEOUS:

Comments of American Telephone & Telegraph Company in Response to Notice of Inquiry, *AT&T Earnings on Interstate and Foreign Services During 1978*, CC Docket No. 79-187 (filed Nov. 13, 1979) 6

Brief of FCC, *New England Telephone & Telegraph Co. v. FCC*, No. 85-1087 (D.C. Cir. filed Mar. 4, 1986) 17

H.R. Rep. No. 1850, 73d Cong., 2d Sess. (1934) 12

H.R. Conf. Rep. No. 213, 73d Cong., 1st Sess. (1933) 12

E. Nichols & F. Welch, *Ruling Principles of Utility Regulation* (1964) 10

A. Priest, *Principles of Public Utility Regulation* (1969) 10

S. Rep. No. 781, 73d Cong., 2d Sess. (1934) 12

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FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,

Respondents.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

Petitioners, several telephone companies divested by AT&T in 1984, respectfully pray that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the District of Co-

lumbia Circuit entered on August 21, 1987. Petitions for rehearing and suggestions for rehearing *en banc* of the decision of the Court of Appeals were denied on November 2, 1988.

OPINIONS BELOW

The decision of the Court of Appeals for which review is sought here is reported at 826 F.2d 1101 and is reproduced in Appendix A, accompanying this Petition. The orders of the Court of Appeals denying petitions for rehearing and suggestions for rehearing *en banc*, together with accompanying statements, are unreported and are reproduced in Appendix B. The order and reconsideration order of the Federal Communications Commission affirmed by the Court of Appeals are reproduced in Appendices C and D. The FCC's initial order is reported at 102 F.C.C.2d 52 (1984). Its order on reconsideration is unreported.

JURISDICTION

The decision of the Court of Appeals for which review is sought was entered on August 21, 1987. The court's orders denying petitions for rehearing and suggestions for rehearing *en banc* were entered on November 2, 1988. This petition has been filed within 90 days of that date, as required by 28 U.S.C. § 2101(c). The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS

The statutory provisions involved in this case are Sections 4(i) and 203 to 205 of the Communications Act of 1934, 47 U.S.C. §§ 154(i), 203-205. They are reproduced in Appendix E.

STATEMENT OF THE CASE

This case involves a fundamental dispute over the rate regulation powers of the Federal Communications Commission ("FCC"). A panel majority of the court below,

consisting of Circuit Judge Mikva and District Judge Parsons,[1] upheld agency action that was taken without any explicit statutory authority whatsoever and, moreover, was in plain conflict with the Communications Act and long settled regulatory law involving parallel federal regulatory acts. A sharply divided Court of Appeals denied suggestions for rehearing *en banc*, and in response, several dissenting judges made it clear why this case should be reviewed:

> "The fundamental issue presented . . . is of manifest importance. Not only are the economic stakes staggeringly high, but the FCC has . . . purported to exercise a power which Congress never conferred upon it. . . . In the process, the Commission's rate-making revolution flies in the teeth of . . . virtues . . . that rate regulatory regimes are designed to foster.
>
> "The errors complained of are, in short, profound." [2]

Ultimately, the resolution of this dispute has major consequences for all of the carriers and ratepayers subject to the Communications Act and, indeed, consequences for those subject to parallel federal regulatory schemes.

Sections 203 to 205 of the Communications Act erect a statutory scheme that balances the interests of ratepayers and carriers by providing stable and predictable charges for both. Under Section 203 of that scheme, a carrier may itself initiate rates, subject to public comment and FCC review. If these rates prove to be too low, the carrier's recourse is to file new rates, but these rates may not seek to make the carrier whole for the inadequate earnings under the first set of rates. On the other hand, if the first rates are determined to be too

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[1] United States District Judge for the Northern District of Illinois sitting by designation pursuant to 28 U.S.C. § 294(d).

[2] App. at 44a (Starr, J., joined by Buckley and Williams, J.J., dissenting).

high, charges collected under those rates are not subject to later refund, unless the FCC, acting under Section 204, had first suspended the rates and then allowed them to go into effect subject to an accounting order pending an investigation into their lawfulness.[3]

Under Section 205 of the Act, the FCC itself is authorized to prescribe, after investigation, "what will be the just and reasonable charge . . . to be thereafter observed." Charges so imposed by the FCC are not subject to subsequent challenge by ratepayers, the FCC or carriers as too high or too low and, therefore, are not subject to retroactive adjustment either. *See Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Ry.*, 284 U.S. 370, 389-90 (1932).

In short, until this case, whether rates were carrier-initiated or FCC-prescribed, ratepayers and carriers knew with certainty the level of their charges, and the Communications Act codified an important balance in protecting this interest. That is, ratepayers were protected from later attempts to boost charges retroactively, whether by collecting additional charges or artificially increasing current rates. Likewise, carriers were protected from later attempts to lower charges retroactively, whether by refunds effected through decreases in current rates or otherwise.

In 1976, however, instead of prescribing specific rates to be charged by AT&T, the FCC prescribed a rate of return of 9.5 percent, plus an additional .5 percent as an incentive to productivity and efficiency.[4] By prescrib-

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[3] An accounting order requires a carrier "to keep accurate account of all amounts received by reason of [a] charge for a new service or increased charge, specifying by whom and in whose behalf such amounts are paid." 47 U.S.C. § 204.

[4] Decision, *AT&T Charges for Interstate Telephone Service*, Docket No. 20376, 57 F.C.C.2d 960, 973 (1976). The FCC's practice of prescribing a rate of return instead of rates had been

ing a rate of return, the FCC required AT&T to file rates which, based on AT&T's best estimates of future demand for service and the costs of that service, would most likely produce an actual return of 9.5 percent. AT&T could not guarantee that its rates would precisely achieve the prescribed return, for the process of setting future rates is inherently one of economic prediction, not an exact science.[5] The FCC's rate of return prescription could be enforced, however, by requiring that the initial rates be targeted to the prescribed return, and if actual returns began to exceed the prescribed return, those rates could be reduced to come thereafter within the prescribed return. Indeed, the FCC stated in its 1976 prescription order that if AT&T's returns exceeded 10 percent, it would merely "require [a] downward adjustment of AT&T's overall interstate rates."[6]

No one, including the FCC, has ever disputed that the rates AT&T filed in 1976 were targeted to achieve the prescribed return of 9.5 percent. In particular, the FCC did not commence an investigation or impose any accounting order under Section 204 related to whether

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recently upheld in *Nader v. FCC*, 520 F.2d 182 (D.C. Cir. 1975), but that decision did not address in what ways the FCC could enforce such a prescription consistently with the Communications Act.

[5] *See Board of Trade v. United States*, 314 U.S. 534, 546 (1942) ("The process of rate making is essentially empiric. The stuff of the process is fluid and changing—the resultant of factors that must be valued as well as weighed"); *Ashland Coal & Ice Co. v. United States*, 61 F. Supp. 708, 713 (E.D. Va.), *aff'd per curiam*, 325 U.S. 840 (1945) ("The process of rate making cannot be solved by the rigid application of algebraic formulae or reduced to the monotonous regularities of mechanical instrumentalities"). For a detailed discussion of the ratemaking process, see *Distrigas Corp. v. FERC*, 737 F.2d 1208, 1211, *vacated*, 751 F.2d 20 (1st Cir. 1984).

[6] 57 F.C.C.2d at 973.

AT&T's rates were appropriately calculated to achieve no more than the prescribed return.[7] In fact, AT&T's rates produced actual returns of 9.25 and 9.59 percent in 1976 and 1977, respectively, amounting to a $100 million shortfall in 1976.[8] In 1978, however, the same rates produced a return of 10.22 percent, or $101 million above the 10 percent maximum allowed by the FCC. For the entire three-year period, these rates produced a return of 9.69 percent, well within the FCC's limit.

Six years later, in 1984, the FCC determined that AT&T's rates were too high in 1978. The FCC ordered AT&T and its former telephone operating companies to refund the 1978 overage by reducing their current charges to make up for the charges that were too high in 1978.[9] It claimed authority to take this action under Sections 205 and 4(i) of the Act, the latter of which permits the agency to take any action "necessary" to executing its functions, provided the action is "not inconsistent with" the Act. No allowance, however, was made for the shortfall in 1976. Because there was no relevant accounting order, the FCC's refund order could

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[7] The FCC did suspend the rates for one day and impose an accounting order on other issues. *American Tel. & Tel. Co.*, 58 F.C.C.2d 1 (1976). That order, however, because it did not make rate of return an issue, is not relevant here, and the FCC has never contended otherwise. Indeed, in allowing the 1976 rates to go into effect the FCC stated: "we cannot find the economic material filed in support of the tariff revisions inadequate or erroneous." *Id.* at 3.

[8] Comments of American Telephone & Telegraph Co. in Response to Notice of Inquiry, at 30, *AT&T Earnings on Interstate and Foreign Services During 1978*, CC Docket No. 79-187 (filed Nov. 13, 1979) (set forth in Joint Appendix before Court of Appeals at 188).

[9] Decision, *AT&T Earnings on Interstate and Foreign Services During 1978*, CC Docket No. 79-187, FCC 84-567, 102 F.C.C.2d 52 (1984) (App. C).

not and did not rely on Section 204, the only provision in the Act that allows for refunds.[10]

The FCC thus imposed a completely new form of rate regulation that created and placed risks of regulatory uncertainty entirely on carriers, and it did this after 1978, depriving AT&T of the opportunity to take protective action, such as seeking a higher rate of return authorization for 1978. By ordering retroactive rate adjustments, the FCC destroyed stability in the regulation of rates. Carriers were also disproportionately burdened because they were required to refund an unforeseeable excess but, at the same time, denied the opportunity to recover a similarly unforeseeable shortfall from a return determined by the FCC itself to be fair.

The FCC's assertion of its new found power has not ended with AT&T's 1978 earnings. Since 1984, the agency has sought to apply this power in other instances. For example, it has unsuccessfully attempted to implement rules that generally required carriers to refund excess returns but did not allow carriers retroactively to recoup earnings shortfalls, a scheme characterized as "turn[ing] the regulatory world upside down" when it was invalidated on appeal.[11] More recently, the FCC has

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[10] *Id.* at 65 (App. at 66a-67a). The court below also found that Section 204 "does not apply to the circumstances of this case." 826 F.2d at 1107.

[11] The D.C. Circuit invalidated the FCC's rules as arbitrary and unreasonable in *American Tel. & Tel. Co. v. FCC,* 836 F.2d 1386 (D.C. Cir. 1988), but did not reach the statutory power issue presented here and in the decision below. *See id.* at 1389. The case was decided while the decision below was pending petitions for rehearing. *Id.* at 1392 n.6. Judge Starr, however, did not see any reason to sidestep the statutory power question and issued a lengthy concurrence rejecting the FCC's "innovations of late [as] without statutory foundation." *Id.* at 1393. Judge Starr went directly to the root of the matter, finding that under the FCC's program, "carriers are no longer able to rely on filed rates; instead, they go about their business in constant jeopardy of being forced

ordered refunds for allegedly excess rates,[12] even though it expressly declined to impose an accounting order prior to allowing the rates to go into effect.[13]

Several parties, including the former AT&T operating companies, petitioned the court below to review the FCC's 1978 refund order. In a split decision rendered August 21, 1987, the Court of Appeals upheld the agency's action, noting, however, that the case involved "fundamental opposition to the agency's view of its regulatory authority." (App. at 10a.) Judge Mikva, writing for himself and Judge Parsons, held that Sections 205 and 4(i) authorized the FCC's action and that the Communications Act did not preclude the retroactive ratemaking effected by that action. Judge Buckley dissented, noting that "[f]or more than 50 years, the Communications Act has been understood to establish a precise, express statutory scheme governing refunds" and that "[n]ever before has [the Act] been held to authorize refunds" in the manner that the FCC asserted. (App. at 22a.)

Upon another split vote, the Court of Appeals denied petitions for rehearing and suggestions for rehearing *en banc* on November 2, 1988. Judge Starr filed a dissenting statement joined by Judges Buckley and Williams. Judge Starr's dissent pointedly noted that the Commission's "clawback approach" to rate regulation

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to refund enormous sums of money . . . . The Commission has turned the regulatory world upside down. The Act, which is purely prospective in design, manifestly does not contemplate this unsettling state of affairs." *Id.* at 1394.

[12] Memorandum Opinion and Order, *Annual 1988 Access Tariff Filings*, CC Docket No. 88-1, Phase II, FCC 88-420 (released Dec. 27, 1988).

[13] Memorandum Opinion and Order, *Annual 1988 Access Tariff Filings*, CC Docket No. 88-1, Phase I, 3 F.C.C. Rcd 2043, 2044 (1988).

did "violence to well-settled, salutary doctrines" and that "the Commission's ratemaking revolution flies in the teeth of the twin virtues of stability and predictability which rate regulatory regimes are designed to foster." (App. at 44a.) Judge Sentelle filed a separate statement noting the importance of the statutory power question but voted to deny rehearing because of multiple recusals by Judges R. B. Ginsburg, Silberman and D. H. Ginsburg. (App. at 45a.) Consequently, as Judge Starr also noted, the law "on a pivotal statutory issue cutting across agency lines" was left "distressingly unsettled." (App. at 44a.) This Petition, to have the matter definitively and correctly decided, followed.

REASONS FOR GRANTING THE WRIT

I. The Court Below Decided a Novel Question Fundamental to Rate Regulation Under the Communications Act in a Manner Contrary to the Act.

The Supreme Court should hear this case because the decision below upholds FCC action that is flatly contrary to the Communications Act and long settled rate regulation law. That law recognizes that the process of setting rates is intrinsically predictive in nature. Inevitably, there will be under or overearnings as expected costs and demand exceed or fall short of actual costs and demand. Permitting retroactive ratemaking, however, to correct for such shortfalls or overages would give rise to continuous revision of past charges.

The practice, therefore, of adjusting current charges to recoup deficient, or to refund excess, past earnings has been prohibited. "The common law of public utility regulation pragmatically accepts the futility of embroiling current and future rate regulation with a function of making correctives for excess or insufficiencies of rates charged in the past." *American Public Gas Ass'n v. FPC*, 567 F.2d 1016, 1057 (D.C. Cir. 1977), *cert.*

denied, 435 U.S. 907 (1978). The courts have repeatedly emphasized this prohibition.[14]

It is evident from an examination of the operation of the Communications Act's provisions themselves that the Act incorporates the same prohibition. The Act's scheme permits carriers to file new rates in order to increase earnings when the return from existing rates becomes too low. Further, the FCC may initiate an investigation into existing rates and prescribe new rates "to be thereafter observed" if the agency believes the existing rates have become unreasonable. Plainly, the basic thrust of these complementary provisions is to provide for prospective correction of existing rates according to procedures that balance ratepayer and carrier interests. Nothing in the Act permits the adjustment of current rates to recoup past deficient earnings, or to refund past excess earnings.

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[14] *See, e.g., Transcontinental & Western Air, Inc. v. CAB*, 336 U.S. 601, 605 (1949) (declining to construe a statute in a manner that would "mark a departure from the customary pattern of fixing rates prospectively" and "break with . . . traditions of ratemaking"); *Board of Pub. Util. Comm'rs v. New York Tel. Co.*, 271 U.S. 23, 31-32 (1926) ("[p]ast losses cannot be used . . . to support a claim that rates for the future are confiscatory . . . . And the law does not require the company to give up for the benefit of future subscribers any part of its accumulations from past operations"); *Distrigas Corp. v. FERC*, 751 F.2d 20, 23 (1st Cir. 1984) ("traditional rate-making principles . . . typically limit the regulator's rate-setting power to *prospective* changes") (emphasis in original); *Nader v. FCC*, 520 F.2d at 202 "[i]t is a cardinal principle of ratemaking that a utility may not set rates to recoup past losses, nor may the Commission prescribe rates on that principle"). *See also* I A. Priest, *Principles of Public Utility Regulation* 75 (1969) ("It has long been established that past deficits may not be made the predicate for striking down rates which are otherwise compensatory, 'any more than past profits can be used to sustain confiscatory rates for the future'"); E. Nichols & F. Welch, *Ruling Principles of Utility Regulation* 315 (1964) (Supp. A) ("Past losses of a utility cannot be recovered from consumers, nor can consumers claim a return of profits and earnings which may appear excessive").

Here, however, the court below upheld FCC action ordering that current rates be reduced below levels that were otherwise authorized in order retroactively to correct past rates and the overearnings they produced, but not underearnings.[15] Not only, therefore, was the agency action upheld below unlawfully retroactive but also it unfairly disadvantaged carrier interests. Although AT&T incurred a shortfall for 1976, the FCC made no allowance for this shortfall when it ordered reduced rates to make up for the 1978 overage. Instead, it announced a regulatory regime under which carriers will be at risk for refunds if their charges, however, carefully calculated, turn out too high, yet there is no correlative impact on ratepayers if those charges turn out too low. The Communications Act, however, is a member of a generation of regulatory enactments containing "precise procedures and limitations" designed to achieve "a careful accommodation of interests" subject to those enactments.[16] The power upheld here fundamentally disregards the Communications Act's carefully balanced plan.

The legislative history underscores the absence of retroactive rate regulation authority in the Communications

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[15] Under the statutory scheme, the FCC's remedy was to order that the rates on file be retargeted to the prescribed return. The FCC made no such order, however, because it was quite apparent that AT&T's costs were actually increasing as inflation spiralled out of control in the latter half of the Seventies. Indeed, the FCC authorized AT&T in 1979 to earn above the 10 percent maximum return allowed in 1976, suggesting, as the carriers have always maintained, that there was nothing unreasonable about the 1978 return, even if it was in excess of the 1976 prescription. *See American Tel. & Tel. Co.*, 73 F.C.C.2d 689, 694-95 (1979). Eventually, the FCC authorized a specific return of 10.50 percent in 1980, *American Tel. & Tel. Co.*, 78 F.C.C.2d 661, 668-70 (1980), and a return of 12.75 percent in 1981. *American Tel. & Tel. Co.*, 86 F.C.C.2d 221, 251 (1981), *aff'd, United States v. FCC*, 707 F.2d 610 (D.C. Cir. 1983).

[16] *American Tel. & Tel. Co. v. FCC*, 487 F.2d 865, 873 (2d Cir. 1973). *Accord United States v. SCRAP*, 412 U.S. 669, 697 (1973).

Act. The Communications Act was patterned after the Interstate Commerce Act.[17] Prior to the enactment of the Communications Act, the Commerce Act was amended to authorize retroactive rate regulation which would recapture excess railroad earnings.[18] The provision for retroactive rate regulation, however, was repealed in 1933 because it was unworkable and had a destabilizing effect on carrier revenues.[19] Nothing like it, therefore, became part of the 1934 Communications Act. The FCC's bald attempt to reintroduce retroactive ratemaking by the order upheld below thus represents not only a departure from the plain statutory scheme established in the language of the Communications Act, but also a repudiation of the clear intent of Congress.

The FCC has employed a device that cannot be found anywhere within the Communications Act's statutory scheme and, in so doing, has replaced the Act's objectives of predictability and stability with unnecessary risk. Gone as well with the FCC's adventure and the decree of the court below that "carriers . . . have no statutory entitlement to a perfectly balanced regulatory scheme" (App. at 15a) is the Act's balanced accommodation of carrier and ratepayer interests. Now, carriers are vulnerable to refunds for overearnings and are without recourse for shortages from underearnings. Because the decision below upholds agency action that fundamentally conflicts with basic ratemaking precepts and the Communications Act's rate regulation scheme, this Court, which has never previously considered that scheme, should grant this Petition to decide the important question presented.

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[17] *See generally* S. Rep. No. 781, 73d Cong., 2d Sess. (1934); H.R. Rep. No. 1850, 73d Cong., 2d Sess. (1934).

[18] 41 Stat. 456, 488-91 (1920).

[19] 48 Stat. 220 (1933). *See also* H.R. Conf. Rep. No. 213, 73d Cong., 1st Sess. 29 (1933).

II. The Decision of the Court Below Is in Conflict with the Decisions of this Court and Other Decisions of the Courts of Appeals.

The ratemaking provisions of the Natural Gas Act and the Federal Power Act parallel the ratemaking provisions of the Communications Act.[20] In each of these ratemaking regimes, the carrier has the authority to initiate new rates. The regulatory commission may suspend and investigate new carrier-initiated rates. It may prescribe lower rates if it finds that the carrier-initiated rates are too high. If it is unable to complete its investigation within the suspension period, it may issue an accounting order requiring the carrier to keep records of the revenues it collected under the new rates so that refunds can be made if the rates are ultimately found to be too high. The commission may also initiate its own investigation and prescribe rates to be charged in the future if it finds existing rates to be unreasonable.[21]

Numerous decisions of this Court and the Courts of Appeals construe the provisions of these regulatory statutes that are essentially identical to the Communications Act to prohibit the kind of retroactive ratemaking upheld below. Therefore, left standing, the decision

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[20] *Compare* 47 U.S.C. §§ 203-05 (Communications Act) *with* 15 U.S.C. §§ 717c-717d (Natural Gas Act) *and with* 16 U.S.C. §§ 824d-824e (Federal Power Act).

[21] The essential similarity among the rate regulation schemes of the Communications Act, Federal Power Act and Natural Gas Act has often been recognized. *See, e.g., Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 577 n.7 (1981) ("relevant provisions of the [Federal Power Act and Natural Gas Act] 'are in all material respects substantially identical'"); *Las Cruces TV Cable v. FCC*, 645 F.2d 1041, 1047 (D.C. Cir. 1981); *American Tel. & Tel. Co. v. FCC*, 487 F.2d at 877 n.21 ("Section 4(e) of the Gas Act gives the FPC a suspension power similar to that of Section 204 of the Communications Act . . . . The prescription authority created by Section 5(a) of the Gas Act is substantially the same as that of Section 205 of the Communications Act").

of the court below will infect the future application of federal regulatory acts that are like the Communications Act. This Court should review the decision below to correct the unsettled state of affairs that has been created.[22]

For example, construing provisions of the Natural Gas Act, this Court has ruled that:

> "The gas operator . . . may . . . file new rate schedules with the Commission. This rate becomes effective upon its filing, subject to the 5-month suspension provision under § 4 . . . . [Section] 5 of the Act . . . authorizes the Commission . . . to institute an investigation into existing rates and charges . . . . Under this section, however, the rate found by the Commission to be just and reasonable becomes effective prospectively only. Gas purchasers, therefore, have no protection from excessive charges collected during the pendency of a § 5 proceeding."

Atlantic Refining Co. v. Public Service Commission, 360 U.S. 378, 389 (1959). Similarly, the Tenth Circuit has noted that "the Commission may order [a] retroactive refund only where a company's rates have been suspended pending a § 4 review." *Colorado Interstate Gas Co. v. FERC*, 791 F.2d 803, 808 (10th Cir. 1986).[23] But for the different section numbering, these could just as easily be statements about Sections 204 and 205 of the Communications Act.

The requirement of prospective relief, as the D.C. Circuit itself explained in a decision construing the Natural Gas Act,

> "is apparent from the language of the Act. Section 5 refers to FERC's power to determine the just and

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[22] The decision below is all the more threatening because it was rendered by the D.C. Circuit, the Court of Appeals that most often reviews the actions of federal regulatory agencies.

[23] *See also Dorchester Gas Producing Co. v. FERC*, 848 F.2d 634, 637 (5th Cir. 1988).

> reasonable rate . . . to be *thereafter* observed . . . . Section 5 . . . conspicuously lacks the explicit provision for refunds and associated accounting requirements found in section 4."

Sea Robin Pipeline Co. v. FERC, 795 F.2d 182, 184 n.1 (D.C. Cir. 1986). Section 205 of the Communications Act, the only substantive provision on which the FCC based its claimed retroactive ratemaking power, contains, of course, the same "thereafter" language.

The decisions of this Court and the Courts of Appeals construing the Federal Power Act reach the same result. For example, this Court stated in *FPC v. Sierra Pacific Power Co.*, 350 U.S. 348, 353 (1956), that the FPC's power under the analogue to Section 205 of the Communications Act was limited to prescriptions " 'to be thereafter observed' and thus can effect no change prior to the date of the order." Thus, as the Court more recently stated in *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578 (1981), "the Commission itself has no power to alter a rate retroactively. When the Commission finds a rate unreasonable, it 'shall determine the just and reasonable rate . . . to be *thereafter* observed and in force.' This rule bars 'the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate.' " (Emphasis in original.)

The First Circuit has stated that under the Federal Power Act, a "utility has no obligation to give customer refunds, even if the rates are found unreasonably high." *Massachusetts v. United States*, 729 F.2d 886, 887 (1st Cir. 1984).[24] Even the D.C. Circuit has ruled that under the Federal Power Act:

> "A customer cannot . . . refuse to pay a rate currently in effect on the ground that it has become

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[24] *Accord Boston Edison Co. v. FERC*, 856 F.2d 361, 368-69 (1st Cir. 1988); *Gulf States Utils. Co. v. Alabama Power Co.*, 824 F.2d 1465, 1471, *modified*, 831 F.2d 557 (5th Cir. 1987).

> unlawfully high and therefore void; nor after payment of such a rate, can the Commission order a refund . . . . [T]he procedures that the statute establishes for adjusting unlawful rates . . . are not at all ambiguous: 'Whenever the Commission . . . shall find that any rate . . . is [unlawful], the Commission shall determine the just and reasonable rate . . . *to be thereafter observed* . . . .' "

Electrical District No. 1 v. FERC, 774 F.2d 490, 492 (D.C. Cir. 1985) (emphasis in original).[25]

In the face of these uniform rulings, the FCC and the panel below sought refuge in Section 4(i) as well as Section 205 of the Communications Act.[26] Section 4(i) does provide that the Commission "may . . . issue such orders, not inconsistent with [the Act], as may be necessary in the execution of its functions." However, "in exercising authority pursuant to Section [4(i)], the Commission's action must not be inconsistent with Sections 203-05."[27] And even if that action does not explicitly conflict with statutory provisions, it must not be in "circumvention of the statutorily prescribed procedures with consequent frustration of the statutory purpose."[28]

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[25] The rate regulation schemes of the Communications Act, Natural Gas Act and Federal Power Act parallel each other because they have as their common template the Interstate Commerce Act. Under the original rate regulation provisions of that Act too, 49 U.S.C. §§ 10704, 10708, 10762, this Court held in *ICC v. American Trucking Ass'ns*, 467 U.S. 354, 361-64 (1984), that retroactive rate action is prohibited.

[26] Indeed, the FCC conceded below that "Section 205 does not specifically provide for the enforcement of Commission prescriptions through refund orders . . . ." Decision, *AT&T Earnings on Interstate and Foreign Services During 1978*, 102 F.C.C.2d at 65 (App. at 67a).

[27] *American Tel. & Tel. Co. v. FCC*, 487 F.2d at 877.

[28] *Id.* at 875.

There is no doubt that the FCC's retroactive rate action here was inconsistent with the Act's regulatory scheme, which requires prospective action. The FCC's action also substantially frustrated the Act's objectives of predictability and balanced interests. The FCC created instability where there was none, and ratepayers were given new protection, while carriers were subjected to broader refund liability than the Act explicitly allows and, moreover, were not protected against underearnings.

In short, Section 4(i) affords no basis for inferring the power asserted here. Indeed, the Natural Gas Act and Federal Power Act contain provisions authorizing agency action "necessary or appropriate" to carry out the provisions of those acts. Yet retroactive ratemaking is prohibited under those acts, even though their interstitial power provisions do not contain the "not inconsistent with" limitation found in Section 4(i) of the Communications Act.[29]

Retroactive rate regulation poses a threat of ominous proportions, particularly if it features the one-sided approach that characterized the agency action upheld below. The FCC's constant approach of forcing downward revi-

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[29] The power that the FCC would infer under Section 4(i) is also unnecessary. The Act already provides a remedy where a return prescription is eventually exceeded: the FCC may prescribe new rates targeted to the prescribed return, and the agency requires quarterly reports by carriers to enable it to determine when rates have gotten out of line. *See* Report and Order, *Amendment of Part 65*, CC Docket No. 86-127, FCC 86-514 (released Dec. 3, 1986). Intentional evasions of a return prescription may be intercepted under Section 204 when the offending rates are filed. In addition, Section 205(b) provides civil fines for knowing failure to file rates designed to comply with an FCC prescription, authorizing sanctions irrespective of when an intentional evasion is discovered, and Section 501, 47 U.S.C. § 501, provides criminal sanctions for willful violations. It should be noted, however, that no one has even suggested, and the FCC, in fact, concedes, that the 1978 overage occurred in good faith. *See* Brief of FCC, *New England Tel. & Tel. Co. v. FCC* at 26, No. 85-1087 (D.C. Cir. filed Mar. 4, 1986).

sions to returns without regard to when returns are deficient would assuredly impair investor confidence and the ability of carriers to raise new capital, ultimately adversely affecting the public interest. That approach has been rejected by this Court and the Courts of Appeals construing other regulatory acts. It is the antithesis of what Congress sought in enacting a regulatory scheme valuing stability, predictability, and balanced carrier and ratepayer interests. Petitioners urge the Court to grant their Petition and protect the legislative intent, resolving the stark conflict in decisions that has been created and making it clear that retroactive rate regulation is prohibited under the Communications Act.

CONCLUSION

For the foregoing reasons, this Petition for a writ of certiorari should be granted.

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No. 88-1249

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IN THE
Supreme Court of the United States
OCTOBER TERM, 1988

SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY, SOUTH CENTRAL BELL TELEPHONE COMPANY, PACIFIC BELL, NEVADA BELL, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY OF MARYLAND, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY OF VIRGINIA, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY OF WEST VIRGINIA, THE BELL TELEPHONE COMPANY OF PENNSYLVANIA, NEW JERSEY BELL TELEPHONE COMPANY, THE DIAMOND STATE TELEPHONE COMPANY, AND SOUTHWESTERN BELL TELEPHONE COMPANY,

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,

Respondents.

APPENDIX TO PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

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TABLE OF CONTENTS

APPENDIX A — Page

Decision Below—*New England Telephone & Telegraph Co. v. FCC*, No. 85-1087 (D.C. Cir. decided Aug. 21, 1987) 1a

APPENDIX B

Orders Denying Rehearing and Rehearing En Banc —*New England Telephone & Telegraph Co. v. FCC*, No. 85-1087 (D.C. Cir. denied Nov. 2, 1988) 41a

APPENDIX C

FCC Refund Order—Decision, *AT&T Earnings on Interstate and Foreign Services During 1978*, CC Docket No. 79-187, FCC 84-567, 102 F.C.C. 2d 52 (1984) 48a

APPENDIX D

FCC Refund Reconsideration Order—Memorandum Opinion and Order, *AT&T Earnings on Interstate and Foreign Services During 1978*, CC Docket No. 79-187, FCC 85-284 (released May 30, 1985) 94a

APPENDIX E

Communications Act of 1934—47 U.S.C. §§ 154(i), 203-205 ..... 130a

APPENDIX A

UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA COURT

No. 85-1087

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
Petitioners

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,
Respondents

GTE SERVICE CORP., *et al.*, NATIONAL TELEPHONE COOPERATIVE ASSOCIATION, *et al.*, AMERICAN TELEPHONE & TELEGRAPH CO., AMERITECH OPERATING CO., MOUNTAIN STATES TELEPHONE & TELEGRAPH CO., *et al.*, SATELLITE BUSINESS SYSTEMS, U.S. TELEPHONE ASSOCIATION, TELECOMMUNICATION RESEARCH & ACTION CENTER, SOUTH CENTRAL BELL TELEPHONE CO., SOUTHWESTERN BELL TELEPHONE CO., *Intervenors*

No. 85-1457

AMERICAN TELEPHONE AND TELEGRAPH COMPANY,
Petitioner

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,
Respondents

U.S. TELEPHONE ASSOCIATION, GTE SERVICE CORP., *et al.*, MOUNTAIN STATES TELEPHONE & TELEGRAPH CO., *et al.*, BELL OPERATING COMPANIES, SOUTHWESTERN BELL TELEPHONE CO., *Intervenors*

No. 85-1471

THE MOUNTAIN STATES TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
Petitioners

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,
Respondents

GTE SERVICE CORP., *et al.*, AMERITECH OPERATING CO., AMERICAN TELEPHONE & TELEGRAPH CO., BELL OPERATING COMPANIES, SOUTHWESTERN BELL TELEPHONE CO., *Intervenors*

No. 85-1472

PACIFIC BELL, *et al.*,
Petitioners

v.

FEDERAL COMMUNICATIONS COMMISSION and the UNITED STATES OF AMERICA,
Respondents

GTE SERVICE CORP., *et al.*, MOUNTAIN STATES TELEPHONE & TELEGRAPH CO., *et al.*, AMERITECH OPERATING CO., AMERICAN TELEPHONE & TELEGRAPH CO., BELL OPERATING COMPANIES, SOUTHWESTERN BELL TELEPHONE CO., *Intervenors*

Petitions for Review of Orders of the Federal Communications Commission

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Argued October 30, 1986

Decided August 21, 1987

Raymond F. Scully, with whom *Alan B. Sternstein, Katherine I. Hall, Saul Fisher, John B. Messinger, Robert L. Barada, Stanley J. Moore, Susan E. Barisone, Vincent L. Sgrosso* and *R. Frost Branon, Jr.*, were on the joint brief for New England Telephone and Telegraph Co., et al., petitioners in Nos. 85-1087 and 85-1472 and intervenors in Nos. 85-1457 and 85-1471.

Jules M. Perlberg, with whom *David J. Lewis, Francine J. Berry, Mark C. Rosenblum* and *Jonathan S. Hoak* were on the brief for AT&T Co., petitioner in No. 85-1457 and intervenor in Nos. 85-1087, 85-1471 and 85-1472. *J. Richard Devlin* entered an appearance for AT&T.

Robert B. McKenna, Jr., Robert W. Barker, L. Andrew Tollin and *Kenneth B. Patrich* were on the joint brief for Mountain States Telephone & Telegraph Co., et al., petitioners in No. 85-1471 and intervenors in Nos. 85-1087, 85-1457 and 85-1472. *Jeffrey B. Bork* entered an appearance for Mountain States Telephone & Telegraph Co.

John E. Ingle, Deputy Associate General Counsel, Federal Communications Commission, with whom *Jack D. Smith*, General Counsel, *Daniel M. Armstrong*, Associate General Counsel, *Jane E. Mago*, Counsel, Federal Communications Commission, *Catherine G. O'Sullivan* and *Robert J. Wiggers*, Attorneys, Department of Justice, were on the brief for respondents in Nos. 85-1087, 85-1457, 85-1471 and 85-1472. *Andrea Limmer*, Attorney, Department of Justice, and *Linda L. Oliver*, Counsel, Federal Communications Commission, entered appearances for respondents.

Alfred Winchell Whittaker and *Thomas J. Reeman* were on the brief for intervenor, Ameritech Operating Companies in Nos. 85-1087, 85-1471 and 85-1472.

Thomas J. O'Reilly and *Patricia McClary* were on the brief for intervenor, U.S. Telephone Association in Nos. 85-1087 and 85-1457.

William Malone and *James R. Hobson* were on the brief for intervenors, GTE Service Corporation, et al. in Nos. 85-1087, 85-1457, 85-1471 and 85-1472.

Daniel Davidson entered an appearance for intervenor, Telecommunications Research and Action Center in No. 85-1087.

Kevin H. Cassidy, J. Manning Lee and *Jeffrey H. Matsuura* entered appearances for intervenor, Satellite Business Systems in No. 85-1087.

William C. Sullivan, Linda S. Legg, Liam S. Coonan, Mary Whitten Marks and *Michael J. Zpevak* entered appearances for intervenor, Southwestern Bell Telephone Company in Nos. 85-1087, 85-1457, 85-1471 and 85-1472.

David Cosson entered an appearance for intervenors, National Telephone Cooperative Association, et al. in No. 85-1087.

J. Roger Wollenberg, Sally Katzen, Andrea Timko, John S. Hannon, Jr. and *Ruth E. Sigler* were on the brief for *amicus curiae,* Communications Satellite Corporation, urging reversal in Nos. 85-1087, 85-1457, 85-1471 and 85-1472.

Before: MIKVA and BUCKLEY, *Circuit Judges,* and PARSONS,* *Senior District Judge.*

Opinion for the Court filed by *Circuit Judge* MIKVA.

Dissenting opinion filed by *Circuit Judge* BUCKLEY.

MIKVA, *Circuit Judge*: Petitioners American Telephone and Telegraph Company ("AT&T") and numerous former Bell operating telephone companies ("BOCs") seek review of orders of the Federal Communications Commission ("the Commission") requiring them to grant rate reductions. The reductions are designed to reim-

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* Of the United States District Court for the Northern District of Illinois, sitting by designation pursuant to 28 U.S.C. § 294(d).

burse consumers for earnings enjoyed by AT&T and the BOCs in 1978 which were over and above a rate-of-return ceiling previously prescribed by the Commission. Petitioners challenge the orders on a number of grounds, the most substantial of which is that the Commission had no authority under the Communications Act to impose such a remedy. We conclude that the Commission had ample authority to order reductions to enforce its prior rate-of-return prescription, and we deny the petitions for review.

I. BACKGROUND

A. *Regulatory Structure*

The Communications Act of 1934, ch. 652, 48 Stat. 1064 (codified as amended at 47 U.S.C.) (the "Act"), provides the regulatory ratemaking scheme within which these petitions arise. Section 203 of the Act places primary responsibility for initiating rate revisions upon the carrier. 47 U.S.C. § 203. Once a carrier initiates a revision, the Commission is empowered under section 204 of the Act to suspend implementation of the proposed tariff for up to five months while it investigates the lawfulness of the proposed rates. 47 U.S.C. § 204. If the Commission's investigation is not completed within that time, the proposed tariff automatically goes into effect. In such a case, however, section 204 empowers the Commission to make the increases subject to an accounting and refund order: if the Commission later determines that the revisions are excessive, it may order the carrier to refund the unjustified amount to those customers who have been overcharged. *Id.*; *see Nader v. FCC*, 520 F.2d 182, 198 (D.C. Cir. 1975).

Section 205 of the Act, which is of particular relevance to this dispute, governs the Commission's authority to regulate existing rates. Under section 205, the Commission can initiate an investigation into any carrier rate or practice. If the Commission determines that a carrier

rate is or will be unlawful under the Act, it may prescribe the "just and reasonable charge . . . to be thereafter observed." 47 U.S.C. § 205. This power of prescription is a potent tool: once the Commission issues a prescription order under section 205, the carrier must "cease and desist from such violation . . . and shall not thereafter publish, demand, or collect any charge other than the charge so prescribed, or in excess of the maximum . . . so prescribed." *Id.*

The Commission in this case also relied on section 4(i) of the Act. That section authorizes the Commission to "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions." 47 U.S.C. § 154(i). As we detail below, section 4(i) previously has been held to justify the use of rate-of-return prescriptions, as opposed to prescriptions of actual rates.

B. *Regulatory History*

Although it had recommended appropriate return levels as early as 1967, the Commission first began to use its section 205 powers to prescribe a rate of return, as opposed to a prescription of actual rates, for the AT&T system in 1972. The Commission decided to undertake a rate-of-return prescription because AT&T had become so huge and diverse that individual rate determinations for each service were impractical. The 1972 order fixed a rate of return of 8.5% and rejected proposed AT&T tariffs that would have provided the company with a higher return. AT&T's challenge to that order called on this court to determine whether the Commission's section 205 powers permitted the agency to prescribe rates of return as well as rates. *See Nader v. FCC*, 520 F.2d 182, 199-205 (D.C. Cir. 1975). In *Nader*, we determined, as a threshold matter, that the Commission's order fixing a rate of return was indeed a prescription. We con-

cluded that "[w]e would be shirking reality if we did not recognize that the practical effect of the Commission's . . . order was to limit prospectively AT&T's rate of return to 8.5%, and thus [the order] was a prescription under section 205." *Id.* at 201; *see also id.* at 202 (the Commission's order was intended "to have the prospective effect of a prescription, thus, limiting the utility to that return.").

We then found that the Commission's prescription of a rate of return was consonant with the agency's statutory authority under the Act. *Id.* at 203-05. Even though section 205 refers only to the Commission's power to prescribe "charges, classifications, regulations and practices," we found that prescription of a rate of return was proper under section 4(i), which gives the Commission the power to issue such orders "as may be necessary in the execution of its functions." *Id.* at 203. In holding that "the Commission lawfully prescribed a rate of return for AT&T," *id.* at 204, we noted that "the effect of the prescription is to protect AT&T from the possibility of refunds on the ground that an 8.5% rate of return was too high, [although] the Commission retains full latitude to order refunds on all other grounds." *Id.* at 205 n.25.

With the issue of its power to prescribe rates of return thus settled, the Commission proceeded in 1976 to set a rate of return of 9.5% for the AT&T system. *See American Tel. & Tel. Co.*, 57 F.C.C.2d 960 (1976). The Commission added to the 9.5% figure a buffer of .5% "in order to provide an incentive to increase productivity and efficiency." *Id.* at 973. In effect, while the Commission prescribed a 9.5% rate, it let AT&T know in advance that it would tolerate "a level or range of interstate earnings not to exceed 10%" before it took remedial action. *Id.*

AT&T responded to the Commission's prescription by filing a tariff structure designed to produce no more than

a 10% rate of return. Without making a specific finding that they were just and reasonable, the Commission permitted these rates to go into effect on March 1, 1976. In 1976 and 1977, the rates produced a rate of return under 10%. However, the same rates in 1978 resulted in a rate of return which all parties agree exceeded the prescribed 10% ceiling.

Although it took a great deal of time to do so, *see Telecommunications Research & Action Center v. FCC*, 750 F.2d 70 (D.C. Cir. 1984), the Commission eventually responded to AT&T's excessive rate of return in December of 1984, when it ordered the company to reduce its rates to refund the excess earnings to consumers. *See* J.A. 23-33. In its order, the Commission rejected AT&T's argument that the 1976 prescription was meant to be not a ceiling on AT&T's rate of return but only a target for setting rate levels; the Commission observed that the plain language in the prescription order restricted AT&T to a return of not more than 10%. J.A. 27. The Commission cited to sections 205 and 4(i) of the Act, as well as our decision in *Nader*, in justifying its authority to enforce its prescription by ordering refunds. J.A. 28. The Commission also rejected AT&T's argument that changing economic conditions had rendered the 10% rate of return unlawfully low and therefore precluded the Commission's enforcement of the rate. The Commission explained that under the Act the carrier bears primary responsibility for initiating changes in existing prescriptions; since AT&T had initiated no such revision, the 1976 prescription remained in effect in 1978. J.A. 27.

The Commission determined that AT&T had enjoyed a 10.22% rate of return in 1978. The Commission derived the 10.22% figure from AT&T's own Interstate Monthly Report ("IMR"), which AT&T had filed with the Commission in January 1979. AT&T subsequently had submitted an "FDC Report" in which the company

maintained that its rate of return for 1978 had been 10.09%. In the proceeding leading up to the orders under review, AT&T urged the Commission to compute the rate reductions based on the 10.09% figure. AT&T insisted that the 10.22% figure did not adequately account for certain services and facilities provided to other common carriers, and that integrating the relatively slight earnings of those services and facilities into the computation resulted in a net rate of return of 10.09%. The Commission, however, chose to rely on the IMR, as it had for the previous 28 years in computing AT&T's rate of return. The 10.22% reflected excessive 1978 earnings for AT&T in the amount of one hundred one million dollars. The Commission ordered AT&T and its former operating companies (AT&T had by this time been divested) to lower its rates by an amount sufficient to reimburse ratepayers for that amount plus interest. J.A. 26.

In two reconsideration orders, the Commission substantially reaffirmed its December 1984 order, imposing only slight alterations not at issue here. *See* J.A. 43-80. Specifically, the Commission again concluded that it had the statutory authority to impose the refunds on AT&T and the BOCs, that its decision did not represent a reversal of longstanding policy not to impose refunds for violations of prescriptions, and that AT&T had earned a 10.22% rate of return in 1978. AT&T and ten BOCs responded with these consolidated petitions for review. The petitioners' efforts to overturn the Commission's orders are championed in whole or in part in intervenors' briefs filed by the Ameritech Operation Companies, the United States Telephone Association, and GTE, and an *amicus curiae* brief filed by the Communications Satellite Corporation.

II. Discussion

Petitioners make three basic challenges to the Commission's orders. The first, and most important, of their

contentions is that the Commission has no authority under the Communications Act to impose refunds for earnings in excess of a prescribed rate of return. A second and related argument is that even if the order did not violate the Act, it departed from prior policy without adequate explanation and with unfairly retroactive effect. Third, petitioners allege various infirmities in the Commission's methods of calculating the amount of the refund liability. We address each of these contentions in turn.

A. *Statutory Authority*

Petitioners' challenge to the Commission's authority to issue the orders under review reveals two points of fundamental opposition to the agency's view of its regulatory authority. First, petitioners differ with the Commission as to the effect of the 1976 prescription. They contend that the nature of their obligation was merely to try in good faith to formulate rates that would not produce an excessive return. In the Commission's view, by contrast, the prescription imposed a maximum return that the carriers could not exceed, however innocently. Petitioners also argue that in any event the Commission has no power to impose refunds to remedy a violation of rate-of-return prescriptions. This argument as to remedy is linked to the first contention: if the prescription obliged the carriers only to design responsive rates, the Commission would be overreaching in adopting a remedy that in effect retroactively adjusts rates that appeared reasonable when implemented. We consider first the nature of the Commission's power to prescribe rates of return and then take up the related issue of the Commission's remedial reach.

Petitioners acknowledge that once the Commission prescribes a rate of return, they are required to submit rates *designed to* achieve no more than that rate. Under petitioners' view of the regulatory scheme, however, that

is all they are required to do; if they err, and rates designed to achieve a lawful return turn out to generate an excess, the prescription has not been violated. Petitioners' argument, in short, is that the Commission may prescribe constraints only on carriers' subjective efforts, not on future events. We see no reason to adopt this narrow reading of "prescription," especially when it is opposed by a more reasonable interpretation by the Commission. *See Chevron U.S.A. Inc. v. Natural Resources Defense Council*, 467 U.S. 837, 843 (1984). The Commission's chief concern in issuing prescriptions is protecting just and reasonable rates, not policing carriers' states of mind. The idea of a prescription under section 205 is that the agency has proclaimed that a certain situation—here a return in excess of 10%—is unlawful and *shall not occur*. Certainly carriers cannot intentionally try to violate an outstanding prescription, but that does not mean that they may achieve through inadvertence what they are forbidden from doing by design.

A central defect in petitioners' argument is a failure to recognize the import of our prior decision in *Nader* approving the Commission's authority to prescribe rates of return. *Nader* established that the Commission may determine what *rate of return* must be thereafter observed in the same way it may set a just and reasonable *rate* to be thereafter observed. We expressly recognized as much when we wrote that the Commission's order had "the prospective effect of a prescription, thus, *limiting the utility to that return.*" *Nader*, *supra*, 520 F.2d at 202 (emphasis added). Here the Commission has exercised its legal prerogative to prescribe a rate of return, rather than a rate. The teaching of *Nader* is that such a prescription is no less binding. If the order setting the maximum rate of return was a valid section 205 prescription, as it clearly was after *Nader*, it had "the force of a statute. . . . The carrier . . . is bound to conform." *Arizona Grocery v. Atchison Ry.*, 284 U.S. 370 (1931). *See also American Telephone & Telegraph*

Co. v. FCC, 487 F.2d 865, 874 (2d Cir. 1973) (carriers are compelled to adhere to prescriptions by Commission).

Having established that the Commission reasonably determined that AT&T's 1978 earnings violated the outstanding prescription, we turn to the question of remedy. Petitioners insist that no section of the Act empowers the Commission to grant refunds for a violation of a prescription. Petitioners point out that section 204 is the only provision in the Act to expressly mention "refunds," and it applies only to Commission action following suspension of new or revised rates; the order under review corrected rates that already had been in effect for two years. Section 205, petitioners observe, is forward-looking: the Commission uses it to prescribe charges and practices "to be thereafter observed." In petitioners' view, by contrast, the Commission's order was a classic example of retroactive ratemaking, which is forbidden under a plethora of case law interpreting sections 204 and 205 and similar provisions in analogous regulatory schemes. Finally, petitioners argue that the Commission cannot cure its lack of authority by reliance on section 4(i), because that provision authorizes only such orders as are "not inconsistent with this Act," and retroactive refunds are inconsistent with the Act.

The petitioners buttress their textual arguments with an observation that the prohibition against retroactive ratemaking is designed to achieve an overall regulatory balance between the interests of consumers, who need protection from unreasonably high rates, and those of carriers, who need assurance of a reasonable rate of return. Under a prospective ratemaking scheme, carriers are precluded from recouping shortfalls during lean years, but they are compensated by being permitted to retain excess earnings from unexpectedly profitable years. This balance, petitioners argue, is destroyed if the Commission can order refunds to enforce a ceiling on a car-

riers' return without also guaranteeing the carriers some minimum reasonable return.

In addressing petitioners' concerns, we note at the outset that although petitioners and the Commission both refer to the rate reductions as a "refund," the order does not impose a refund in the classic sense of restitution to an overcharged party. Here the reductions will accrue to the benefit of a different customer base from the base that contributed to AT&T's excessive earnings. The Commission's order therefore is more precisely considered a prospective rate adjustment to compensate for past surpluses. *See* J.A. 26. This case does not, however, turn on the arguably overfine semantic distinction between a refund and a prospective adjustment: even allowing for argument's sake that the Commission imposed a refund, the order was well within the agency's statutory authority.

As petitioners observe, section 204 is the only provision of the Act explicitly to mention refunds, and it does not apply to the circumstances of this case. The Commission, however, relied on another section of the Act—section 4(i)—to impose rate reductions in the amount of AT&T's excessive 1978 earnings. That provision empowers the agency to perform any act "not inconsistent with this Act, as may be necessary in the execution of its functions." We find this wide-ranging source of authority adequately supports the Commission's remedial action. In a strictly technical sense, the Commission's choice of remedy was absolutely necessary; without the reductions, the carriers in fact would not be limited to a return of 10% and the prescription would be violated. More generally, the Commission enjoys significant discretion to choose among a range of reasonable remedies, including refunds. *See Las Cruces TV Cable v. FCC*, 645 F.2d 1041, 1047 (D.C. Cir. 1981). The Commission does not have to show that it selected the only conceivably appropriate remedy in order to invoke its 4(i) powers. *See*

North American Telecommunications Ass'n v. FCC, 772 F.2d 1282, 1292 (7th Cir. 1985) (section 4(i) is a "necessary and proper clause" empowering the Commission to "deal with the unforeseen . . . to the extent necessary to regulate effectively those matters already within the boundaries"). Although, as petitioners point out, there are other corrective measures the Commission might have chosen, the measure it adopted in this case was appropriate and reasonable. As we said recently in another case approving of an agency's refund order, "[t]he question eventually reduces to one of judgment, informed by the policy of the statute that Congress has seen fit to enact. We find the agency's judgment . . . to be fully consistent with the Commission's broad mandate from the Article I branch to assure that all rates are just and reasonable." *Southern California Edison Co. v. FERC*, 805 F.2d 1068, 1072 (D.C. Cir. 1986).

Petitioners nevertheless insist that a refund remedy is inconsistent with the Act, and therefore an inappropriate exercise of power under section 4(i), because it amounts to retroactive ratemaking. This argument again overlooks the force of our decision in *Nader* and the Commission's subsequent 1976 rate of return prescription. There was not retroactive ratemaking here, because the carriers' obligations were set prospectively in 1976, when the Commission forbade AT&T from earning more than 10%. The 1984 order under review merely recognized that the prior prescription had been violated and imposed a remedy for that violation. As the Commission explained, the refund order is a "dispassionate remedy for a violation in fact of an earnings ceiling. The carriers are being required merely to give up what they never should have collected in light of the rate of return prescription." FERC Br. 25 n.31. This case is thus no different from one in which the Commission prescribed actual rates and the carrier, either intentionally or inadvertently, collected higher charges. Although no car-

rier has yet been so brazen, there can be little doubt under such circumstances but that the Commission would be well within its authority in forcing the carrier to disgorge the unlawful excess. *Cf. United States v. Corrick*, 298 U.S. 435 (1936) (Commission can reject rate *filings* in excess of prescribed rates). The Commission has no more engaged in retroactive ratemaking here just because it is acting to enforce a rate-of-return prescription rather than a rate prescription.

Nor does the Commission order foster an impermissible imbalance between the interests of carriers and those of consumers. First, the Commission's 1976 prescription did provide a measure of protection for the carriers. As we noted in *Nader*, "the effect of the prescription is to protect AT&T from the possibility of refunds on the ground that an 8.5% rate of return was too high." 520 F.2d at 205 n.25. Thus, had the cost of capital plunged in 1977, so that AT&T's return in that year of 9.59% was far above the reasonable minimum necessary to attract continued investment, the Commission nevertheless would not have been able to order a refund; rather, it would have had to initiate a new Section 205 proceeding and issue a new rate-of-return prescription, which would have had prospective force only.

It is true that the current regulatory scheme is asymmetric on another level. Since the Commission has so far declined to set minimum guaranteed rates of return for the carriers (although it has not foreclosed the possibility of doing so in the future), carriers must refund excess earnings, but they are not compensated for shortfalls. The carriers, however, have no statutory entitlement to a perfectly balanced regulatory scheme; rather, they are entitled only to earn an overall reasonable return. The Commission has concluded that a guaranteed minimum annual return is not essential to protect that right. That conclusion is a reasonable one. Under the Act, the carriers have the opportunity and responsibility

to file rates that provide an adequate return. In this sense they are unlike consumers, who rely predominantly on the Commission to protect their right to just and reasonable rates. Moreover, the Commission supplements its rate-of-return prescriptions with a buffer, in this case amounting to .5%. This added increment makes it easier for the carriers to design charges that provide a rate of return in the vicinity of the prescribed ceiling. This scheme, in fact, more than adequately protected the carriers' interests in relation to the 1976 rate-of-return prescription at issue. During the five-year period in which the prescription was in effect, AT&T failed to earn less than the prescribed ceiling of 9.5% in only one year, 1976, when it earned 9.25% Overall, its average earnings during that period were 9.69%, well *above* the prescribed limit. In three of the five years, the carrier's rates were designed precisely enough to produce a return above the ceiling but not so far above as to trigger a Commission remedy. Finally, the carriers can always initiate a request to increase their rates when the current tariff appears likely to result in a shortfall. Thus, the current system appears to provide ample protection for the carriers' interests without any guaranteed minimum rate of return. Should this state of affairs not hold in the future, the Commission and the courts can address the situation at that time.

In sum, the Commission was justified in finding that AT&T's excessive earnings in 1978 violated the agency's outstanding rate-of-return prescription. Having made that finding, the Commission properly exercised its authority under section 4(i) to remedy the violation by ordering rate reductions in the amount of AT&T's excessive earnings in 1978.

B. *Retroactive Application of a Newly-Announced Policy*

Several petitioners argue that even if the Commission's order did not violate the Act, it represented an abrupt reversal of prior Commission policy which could

not lawfully be applied to parties who relied on the previous state of affairs. As AT&T sees it, for example, the Commission previously had followed a "target/trigger" policy, under which rate-of-return prescriptions served as targets for carrier tariffs, and excessive earnings triggered prospective relief in the form of rate adjustments. AT&T argues that it is being unfairly subjected to newly-adopted regulatory standards to which it has not had an opportunity to conform its behavior.

In large part, this claim relies on the same premise as the argument that the prescription obliged the carriers only to design rates not to exceed the Commission's ceiling. To the extent it does, we reject it for the same reasons. Once the Commission prescribed a maximum rate of return of 9.5% with a .5% buffer, it was not reasonable for the carriers to think that the agency had an affirmative policy of permitting carriers who earned above 10% to retain the unlawful excess. It is true that the Commission had not put the carriers on specific notice that it would respond to unlawfully high returns by ordering refunds. Importantly, however, the Commission had not had occasion to do so; never before had a carrier exceeded a rate-of-return prescription.

The dissent contends that carriers twice before—in 1967 and 1968—exceeded the prescribed rate of return. Dissent at 4, 9-10. This contention is a cornerstone of the dissent's argument that the enforcement scheme adopted in this case represented a radical change in policy. The dissent overlooks the vital point that the Commission first prescribed a rate of return in 1972. Although it incorporated a rate-of-return recommendation, the 1967 order was not a rate-of-return prescription, and thus the portion of that order the dissent cites, *see* dissent at 4, is immaterial. The whole point behind our decision today, and our previous holding in *Nader*, is that the ratemaking regime changed in 1972 when the Commission began to use its section 205 powers to

prescribe rates of return. That action represented a new approach to rate regulation, and its legitimacy was precisely what the fight was about in *Nader*.

Given that no carrier had ever exceeded a prescribed rate of return and that the Commission had never foreclosed the remedy it imposed in this case, the most petitioners can claim is that the order under review instituted a new policy for a new situation. This action is something very different from a departure from a clear prior policy. We recently recognized the distinction in rejecting a very similar claim that an agency refund order was a departure from prior precedent. Petitioner in that case contended that the Federal Energy Regulatory Commission retroactively applied a new policy when it ordered a refund of excessive earnings. *See Southern California Edison Co. v. FERC*, 805 F.2d 1068 (D.C. Cir. 1986). The court noted, "no agency precedent expressly addresses this precise issue . . . . We are in new territory here." *Id.* at 1071. Confronted with a novel set of circumstances, as we are in this case, the court rejected petitioner's claim that the Commission had departed from prior policy.

Finally, even if the enforcement order instituted a departure from a previous clearly articulated policy, petitioners would have no right to have the "new" policy not apply to them. Generally speaking, an agency may be prevented from applying a new policy for one of two reasons (in addition to the standard constraints that apply to any agency decision). First, a departure from prior policy cannot stand when the agency fails to explain the reason for the change. *See Greater Boston Television Corp. v. FCC*, 444 F.2d 841, 852 (D.C. Cir. 1970), *cert. denied*, 403 U.S. 923 (1971). Second, under certain circumstances an agency may be prevented from applying a new policy retroactively to parties who detrimentally relied on the previous policy. *See RKO General v. FCC*, 670 F.2d 215, 223 (D.C. Cir. 1981), *cert. de-*

nied, 456 U.S. 927 (1982). Petitioners can avail themselves of neither of these doctrines. As we detailed above, the Commission amply explained the source and need for its authority to remedy violations of its prescriptions by imposing refunds. This explanation fulfilled the Commission's responsibilities under *Greater Boston*. As for the retroactivity claim, petitioners have made no showing whatsoever of detrimental reliance. Indeed, it is difficult to imagine how they might make such a showing. Petitioners have insisted, as they must, that they made every effort to comply with the prescription by designing rates that would produce earnings of less than 10%. Presumably they would have behaved no differently had they clearly understood that excessive earnings might trigger a refund order. Thus, there is no evidence that petitioners relied to their detriment on their understanding of the Commission's prior policy. In sum, even had petitioners demonstrated, which they have not, that the Commission's order departed from prior policy, they would have no equitable claim to shield them from application of the order to them.

The dissent posits that AT&T relied on an enforcement scheme that precluded refunds by not filing for rate increases and by not having an opportunity *in 1978* to convince the agency that its earnings were reasonable under then-prevailing economic conditions. Dissent at 13-15. But AT&T had every incentive and opportunity to file for an increase if it believed that the outstanding rate-of-return prescription was inadequate. It is irrational to surmise that the carrier would have declined to try to maximize its allowable profits in 1979 because it believed it would be able to retain its windfall of 1978. As for its opportunity to protest the decision, AT&T has offered a fierce challenge now, so no remedy has been assessed without the carrier's having had a full opportunity to air all its claims. We thus can perceive no possibility of detrimental reliance in this case.

C. *Computation of the Refund*

Three final arguments address the Commission's actual computation of petitioners' liability. First, petitioners claim that the Commission should have calculated the carriers' rate of return over the entire period during which the rates at issue were in effect, rather than isolating AT&T's excessive earnings for 1978. The rates were in effect from 1976 to 1980, during which they produced an overall rate of return of 9.69%. The Commission admittedly gave only a cursory explanation for its decision to enforce the prescription on an annualized basis. It reasoned in a footnote that it adopted a calendar-year measure because carriers' revenues, expenses, and income tax liabilities are typically evaluated on a fiscal year basis, and AT&T's own fiscal year coincided with the calendar year. J.A. 25-26 n.12. This explanation, while brief, is sensible enough, especially since the Commission was enforcing a prescription of an annual rate of return. Moreover, prescriptions usually remain in effect for an indefinite period. Under petitioners' preferred scheme, the Commission would never be able to find and remedy a violation until it opted to issue a new prescription, because the agency would not know until then over what period the prior prescription was in force. In short, while the Commission perhaps might have opted for a different interval of measurement, *cf. Authorized Rates of Return*, 50 Fed. Reg. 41350 (October 10, 1985) (two-year interval), its choice of the traditional calendar year certainly was not unreasoned.

Petitioners also urge that the FCC failed to meet its burden of adducing substantial evidence for its determination that AT&T earned a 10.22% return in 1978. The Commission, however, amply supported its decision to rely on the 10.22% figure in the IMR that AT&T filed in January 1979 rather than the 10.09% figure in the subsequent FDC Report. First, the Commission pointed out that the agency and the industry had relied on the IMR return figures for 28 years, whereas the FDC Re-

ports first had been submitted in 1977. J.A. 25. Second, certain of the computations in AT&T's FDC Report relied on extrapolations from the month of June 1978, even though, in the Commission's opinion, AT&T had not shown that the June figures were perfectly representative of the year's earnings. *Id.* Thus, the Commission adduced substantial evidence for both its confidence in the traditional IMR and its lack of confidence in the FDC Report that AT&T urged the Commission to employ. We therefore have no cause to doubt the reasonableness of the Commission's reliance on the 10.22% figure.

Finally, intervenor United States Telephone Association argues that the Commission should not be able to require petitioners to pay interest on the excess earnings for the entire period between January 1, 1979, and the date on which carriers file tariffs to implement the refund. USTA believes the Commission abused its discretion in ordering full interest payments in light of the Commission's own prolonged delay in responding to the violation. While this court does not condone the Commission's delinquency in resolving this matter, *see Telecommunications Research & Action Center v. FCC*, 750 F.2d 70 (D.C. Cir. 1984), we perceive no inequity in requiring petitioners to pay full interest on earnings they had no right to retain in the first place.

III. Conclusion

The order under review was a straightforward and legitimate means for the Commission to enforce its 1976 rate-of-return prescription. In ordering a rate reduction in the amount of petitioners' excessive earnings, the Commission acted within its authority under the Communications Act and did not depart from prior policy. Finally, the Commission's method of computing the excess was reasonable and supported by substantial evidence. For these reasons, the petitions for review are denied.

It is so ordered.

BUCKLEY, *Circuit Judge, dissenting*: Section 4(i) of the Communications Act is sufficiently broad and the principles of deference to agency decisionmaking sufficiently strong that, in the judgment of the majority, the FCC has statutory authority to enforce a prescribed maximum rate of return. Correct or not, the majority overstates the case. For more than fifty years, the Communications Act has been understood to establish a precise, express statutory scheme governing refunds and the setting of rates. Never before has section 4(i) been held to authorize refunds. While there is always a time for firsts, I think it must be admitted that, even if lawful, the FCC here operates at the feather edge of its statutory authority.

This is not the occasion to decide the statutory issue. Without notice, the FCC altered its fundamental policy basing rates of return exclusively on *current* market conditions, and instead ordered a reduction in future rates based on *past* surplus. The *Refund Order* should be set aside because it contradicts the system of ratemaking previously articulated and applied by the FCC.

I. RETROACTIVITY DOCTRINE

In this circuit, as we have so recently confirmed, the test presented in *Retail, Wholesale & Dep't Store Union v. NLRB*, 466 F.2d 380, 390 (D.C. Cir. 1972), "provides the framework for evaluating retroactive application of rules announced in agency adjudications." *Clark-Cowlitz Joint Operating Agency v. FERC*, No. 83-2231, slip op. at 14 (D.C. Cir. Aug. 11, 1987) (en banc). Five "non-exhaustive" factors are set forth therein to distinguish between legitimate retroactive application of policy and those instances when an agency must proceed prospectively:

> (1) whether the particular case is one of first impression, (2) whether the new rule represents an

> abrupt departure from well established practice or merely attempts to fill a void in an unsettled area of law, (3) the extent to which the party against whom the new rule is applied relied on the former rule, (4) the degree of the burden which a retroactive order imposes on a party, and (5) the statutory interest in applying a new rule despite the reliance of a party on the old standard.

Retail, Wholesale, 466 F.2d at 390.

Taking the test in reverse order, I summarize my objection to the 1984 *Refund Order*: (1) Unlike the typical case in which an agency announces a rule through an adjudication, the FCC has formally and expressly admitted that the 1984 refund order "was not intended to establish a rule for all future proceedings . . . ." Return Interstate Services of AT&T Communications and Exchange Telephone Carriers, 50 Fed. Reg. 33,786, 33,788 (1985) (proposed Aug. 21, 1985). Instead, the FCC subsequently engaged in formal rulemaking to announce a policy of automatic refunds under specified circumstances. Authorized Rates of Return for Interstate Services of AT&T and Exchange Telephone Carriers, 50 Fed. Reg. 41,350 (1985) (final rule); Return Interstate Services of AT&T Communications and Exchange Telephone Carriers, 51 Fed. Reg. 1,795 (1986) (to be codified at 47 C.F.R. Part 65). Hence the retroactive application of the policy in the present case advances *no statutory purpose*; (2) The *Refund Order* imposes a $101 million penalty on AT&T plus interest for rates filed in 1976 and *never changed* until 1980. This is a burden by any standard. *See NLRB v. Bell Aerospace Co.*, 416 U.S. 267, 295 (1974) (prospective application favored when "fines or damages" are assessed and agency imposes new liability "for past actions which were taken in good-faith reliance on [agency] pronouncements."); (3) AT&T relied on the settled statutory scheme, confirmed in count-

less cases, that refunds, to be lawful, can only arise by operation of section 204 of the Communications Act. Furthermore, this court finds that were it not for section 4(i), the FCC order would be conclusively and without question unlawful. *See* Maj. at 14, 17; *see also MCI Telecommunications Corp. v. FCC*, 765 F.2d 1186, 1195 (D.C. Cir. 1985) ("In enacting Sections 203-05 of the Communications Act, Congress intended a specific scheme for carrier initiated rate revisions. A balance was achieved after careful compromise. The Commission is not free to circumvent or ignore that balance. Nor may the Commission in effect rewrite this statutory scheme on the basis of its own conception of the equities of a particular situation.") (quoting *American Telephone and Telegraph Co. v. FCC*, 487 F.2d 865, 880 (2d Cir. 1973)); *Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 189 n.7 (D.C. Cir. 1986) (The Commission "may not order a retroactive refund based on a post hoc determination of the illegality of a filed rate's prescription."); (4) The FCC cannot and does not cite a single sentence from among hundreds of pages of its regulatory decisions detailing the policy upheld today. Rarely are departures from established policy as abrupt; (5) The majority states that "the Commission first prescribed a rate of return in 1972. Although it incorporated a rate-of-return recommendation, *the 1967 order was not a rate-of-return prescription*, and thus the portions of that order the dissent cites . . . are immaterial." Maj. at 18 (emphasis added). Yet the FCC in its own rulemaking expressly holds to the contrary:

> This Commission established a *prescribed* rate of return for the interstate telecommunications services of [AT&T *in 1967*]. That *prescription* was revised in 1972, 1976, and 1981.

50 Fed. Reg. at 33,786 (1985) (footnotes omitted); *see also* 57 F.C.C.2d 960, 960 (1976) ("This proceeding rep-

resents the third time [1967, 1972, & 1976] the Commission has considered the fair rate of return of [AT&T] . . . .''). As a matter of logic, it is untenable to argue that remedying an excess rate of return represents a case of "first impression." This is a core function of any rate regulator. As a matter of fact, the FCC twice before was confronted by AT&T rates in excess of the prescribed return. *See infra* at 9-10.

It ultimately took the FCC six years to reach the conclusion that it (a) had the authority and (b) had given AT&T lawful notice that returns earned in excess of the prescribed rate of return would be subject to future disgorgement. The majority says this power came into being in 1972. The FCC nowhere in its brief or on the record makes this argument. Indeed, the alteration in the FCC position is dazzling. In 1967, the FCC said "the policies we are establishing on the basis of the record of this proceeding require no drastic change in any of the standards heretofore applied and represent no new or essentially different approach by this Commission to the regulation of respondents' interstate rates and earnings." 9 F.C.C.2d 30, 116 (1967). In its brief in the instant case, the agency said "[t]he fundamental flaw in the carrier parties' arguments in this case is that they either fail or refuse to recognize that the 1976 prescription order altered the normal pattern of carrier initiated rates under the Communications Act." Brief for Respondents at 17. At oral argument, counsel withdrew this statement. In 1987, the FCC states that it first announced the refund policy in 1984, or perhaps as early as 1979 when it issued a notice calling for comments on the subject. Brief for Respondents at 47-48, 48 n.62, *American Telephone and Telegraph Co. v. FCC*, Nos. 85-1778, *et al.* (argued before D.C. Cir. May 21, 1987).

Fortunately, an administrative record exists to sort out which of these various arguments were actually set down

on paper to guide the conduct of the industry the FCC is charged with regulating.

II. The Record

The FCC in 1984 ordered prospective rate reductions to compensate consumers for revenues earned by AT&T in 1978 based on tariff rates filed in 1976. The majority correctly describes this remedy as a policy of "prospective rate adjustments to compensate for past surpluses." Maj. at 14. The majority incorrectly describes the remedy as a new policy meeting a novel set of circumstances.

FCC policy governing rate-of-return regulation is contained in the administrative rulings pertaining to changes in tariffs for AT&T in 1967, 1969, 1972, and 1976. 9 F.C.C.2d 30 (1967); 21 F.C.C.2d 654 (1969); 38 F.C.C.2d 213 (1972); 57 F.C.C.2d 960 (1976). As I read these decisions, the FCC policy to remedy excessive tariffs consists of the exercise of agency authority at three successive stages: (a) pre-filing establishment of target revenues, (b) post-filing accounting pursuant to section 204 of the Act, 47 U.S.C. § 204, and (c) prospective rate adjustment, up or down, as demanded by the current economic forces in the marketplace. 47 U.S.C. § 205. The coordinated exercise of the agency authority in the first two stages in large measure eliminates the likelihood of overcharges. The option to reset future rates based on then current conditions provides the vehicle to insure that rates continue to be appropriate over time. As this schema assures adequate protection against excessive charges, the FCC has not been faced by a novel threat. Furthermore, FCC decisions amply document these propositions.

In 1967, the FCC adopted a new method for regulating telephone rates. Instead of working from a reconstruction of each cost component incurred by AT&T, a technical and time-consuming nightmare, the FCC settled on

a top-down approach based on rate of return. The required rate of return, also known as the cost of capital, is that rate "sufficient to assure confidence in the financial integrity of the enterprise, so as to maintain its credit and to attract capital," balanced against the public interest in just and reasonable rates. 9 F.C.C.2d at 53 (quoting the Supreme Court's "landmark" case, *Federal Power Comm'n v. Hope Natural Gas Co.*, 320 U.S. 591, 603 (1944)).

Conceptually, the cost of capital is divided into two components: the cost of debt, which is the interet rate enterprises must offer to attract secured funds; and the cost of equity, which is the rate of return investors must be offered to compensate them for the risk of investing in a company's stock. Because investors have numerous alternative investment prospects, the cost of capital approach to ratemaking necessarily focuses on the prospective return demanded by investors for investments of comparable risk. Thus, AT&T's cost of capital will change as necessary to reflect marketplace reassessments of these alternatives. If the rate of return earned by AT&T is set too low, it will not be able to attract either the debt or equity capital necessary to serve current consumers and meet future increases in demand. If set too high, the public interest suffers. *See, e.g.*, 9 F.C.C.2d at 52.

Rate regulation thus shifted in 1967 to a two-step process. The FCC would fix the target *rate of return*, and the carrier would set *tariff rates* designed to earn this rate of return. In either system, whether before or after 1967, there is the risk of error. In the first, *historical* costs can be misestimated and long delays and expense incurred in gathering accurate data. In the second, the FCC has recognized, and therefore so must we, that there is an inherent imprecision to measuring the *prospective* and *changing* rate of return demanded in the marketplace and a further imprecision in then requiring the carrier to set tariff rates that will produce the exact

level of revenues which, after expenses have been deducted and the rate base fixed, will produce the anticipated return. *See, e.g.*, 9 F.C.C.2d at 51-88; 38 F.C.C.2d at 248-51. The so-called "novel circumstance" of a surplus rate of return is in fact a central feature of rate-of-return regulation.

Notwithstanding these differences in the approach to setting tariff rates, only the means of regulation changed in 1967, not the basic policy. As noted, the FCC put this point beyond doubt:

> [T]he policies we are establishing on the basis of the record of this proceeding require no drastic change in any of the standards heretofore applied and represent no new or essentially different approach by this Commission to the regulation of respondents' interstate rates and earnings. On the contrary, the record and our decision confirm the regulatory standards we have generally applied over the years. Thus, prior to 1964, we permitted the respondents to maintain a level of interstate earnings within the range of 7 to 7.5 percent. When the level of earnings tended to exceed this range, we were successful, under our program of continuing surveillance, in negotiating corrective rate adjustments.

9 F.C.C.2d at 116.

The decision also affirmed that "corrective rate adjustments" would continue to be the mechanism employed to adjust for prior year excesses:

> As, and when, the going level of respondents' interstate earnings approaches either the upper or lower limits of this [7 to 7.5 percent] range, we will promptly consider what further action may be required *in light of then current conditions.* This is not to be construed to mean that any future level

> of earnings which exceeds 7.5 percent or falls below 7 percent will warrant immediate action *looking toward rate adjustments.* Whether or not remedial action will be required will depend upon *all the relevant circumstances obtaining at the time.*

Id. (emphases added).

When read in context, and in light of subsequent decisions, it is evident that "remedial action" contemplated the filing of revised tariff schedules designed to reduce or increase future rates in accordance with the rate of return appropriate to circumstances at that time. The cost of capital approach can make no sense otherwise. Investors lending funds or buying equity always focus on present alternative investments, not prior circumstances.

In 1970, AT&T filed a proposal to increase interstate charges on message telephone service by "some $760 million." 38 F.C.C.2d at 215. AT&T estimated the new charges would yield a rate of return approximating 9.5 percent, the rate required by current conditions according to AT&T. In the 1972 proceedings, the FCC specified "a range of 8.5-9.0% as the range of reasonableness for the earnings of Bell on its interstate operations at the tariff rates that we are allowing Bell to file herein." *Id.* at 245. This is the prospective rate adjustment system in action. Only after evaluating operating results and revenue requirements did the FCC translate the increase in *rate of return* into a permissible *tariff rate* increase designed to produce $145 million in *incremental revenue. Id.* at 248-51. In the decision, the FCC reiterates that adjustments in the system come through prospective adjustments in tariff filings. *See id.* at 226-27.

Last, we reach the 1976 round of increases at issue in this case. AT&T, as usual, initiated the process in 1975 with a proposed $717 million rate increase. The FCC, exercising its prospective powers to control rates,

determined the increase would exceed the rate of return then in place, and denied the proposal. 51 F.C.C.2d 619, 626-27 (1975). In other words, the policy functioned in 1976 exactly as designed—it prevented an increase in rates the FCC concluded to be unwarranted by then current conditions as measured by the rate of return.

The filing, however, prompted the FCC to investigate and update the rate of return applicable in 1976 from 8.5-9.0 percent to 9.5 percent plus .5 percent as an efficiency incentive. 57 F.C.C.2d 960, 972-73 (1976). Once again, in accordance with its established practice, the FCC ordered a *prospective* adjustment in the target increase for revenues. Moreover, by suspending the 1976 tariff filing for one day, the FCC triggered its statutory authority to control rates *retroactively* pursuant to section 204 of the Act, which states in pertinent part:

> [U]pon completion of the hearing and decision [the FCC] may by further order require the interested carrier or carriers to refund, with interest, to the persons in whose benefit such amounts were paid, such portion of such charge for a new service or increased charges as by its decision shall be found not justified.

47 U.S.C. § 204(a) (1982). Although the agency did not see fit to pursue the section 204 remedy in this case, the essential point in terms of the regulatory regime is that the agency is empowered by the statute to conduct an accounting of actual results and, after a hearing, order a refund if necessary to reimburse consumers who had paid excessive charges.

III. Application To Retroactivity

This survey of the relevant FCC decisions compels the conclusion that the FCC's 1984 refund order abruptly reversed its prior policy by basing prospective tariff rates on prior returns in excess of the target levels, instead

of on market conditions. Until 1984, the FCC's regulation of AT&T's rates was based *exclusively* on a forward-looking assessment of economic conditions. After 1984, the FCC order holds that rates may be reduced to compensate for past experience. The majority neatly encapsulates this abrupt switch by describing the new refund policy as a "*prospective rate adjustment* to compensate for *past surpluses*." Maj. at 14 (emphasis added).

A. *Novel Circumstance*

The majority seeks to justify the refund policy as a licit response to novel circumstances. In the first instance, this premise of novelty stretches the facts. In 1967, the FCC established a rate of return in the range of 7 to 7.5 percent. Based on this rate, the FCC calculated that AT&T's rates then in place were excessive. The remedy ordered was to reduce future rates to produce a $120 million reduction in revenues. At the new rate level, AT&T would earn the rate of return required by then current conditions. It was never suggested that the return should be lowered by $120 million to reflect current conditions, and then *further* reduced to collect the past overage. *See* 9 F.C.C.2d at 116.

Likewise, the agency in 1969 determined that actual charges in 1967 exceeded the allowed rate of return. 21 F.C.C.2d at 655. Again, the FCC neither ordered nor contemplated refunds. Rather, it expressed the familiar policy that "when there were departures from this range, [it would] consider the matter in light of conditions obtaining at that time." *Id.* The FCC thereupon reviewed the excess earnings on the basis of "changes which have taken place *since 1967* in the economic, financial, and other conditions that affect AT&T's revenue requirements and its ability to attract new capital"; and concluded that earnings exceeding the 1967 rate of return "[were]

not unreasonable." *Id.* (emphasis added). AT&T was not required to reduce its filed tariffs.

The rate-of-return method of regulation was new in 1967, and, according to the majority, the rate-of-return prescription did not fix a maximum cap on the allowable return until 1972. This claim of a major sea-change in the 1972 proceeding is contradicted in the record, *see supra* at 3-4, disavowed by the FCC, Brief for Respondents at 19 ("The [1976] rate of return prescription enforced in this case, like every other such prescription the FCC has made, was implemented . . . with prospective, binding effect." (footnote omitted)), and unsupported by the *Nader* decision. See 50 Fed. Reg. at 33,786 n.1 ("The *Nader* opinion interpreted prior FCC decisions [back to 1967] as prescribing a rate of return for AT&T . . . ."). In any event, in terms of the assertion of novelty, these are distinctions without a difference. The FCC even in the pre-1967 regime used rates of return to evaluate the revenues allowed after costs. Moreover, the regime between 1967 and 1972 prescribed rates and hence presented the precise issue whether the increment over the targeted rate of return should be retained. Pursuant to the majority's logic, the FCC had the authority to order prospective rate adjustments as the enforcement remedy. The fundamental fact is that the agency twice before explicitly faced the problem of actual charges in excess of the announced range.

Second, common sense rebuts the majority's contention. It cannot be argued that the FCC simply failed to anticipate the essential issue of rate regulation, namely, what steps the agency should take to ensure compliance with its rate-of-return orders. In a system of carrier-initiated rates, it is unreasonable to suppose that the agency established the rate-of-return framework without giving a single thought to the prospect of what would happen if the filed tariffs produced a return in excess of the allowed maximum.

Finally, the FCC concedes, as it must, that not a single sentence in any report suggested that prospective rate adjustments might be ordered to compensate for past surplus. The omission would be almost inexplicable in a system of rate regulation that inherently can produce errors resulting in overshooting or undershooting the targeted rate of return. The FCC's three coordinate powers, as summarized below, explain the silence that the majority inaccurately construes to be evidence of a novel circumstance.

As part of the process setting the rate of return, the FCC approves or disapproves specific requests for target increases in tariff *revenues*. The revenues analysis is conducted to confirm that AT&T's probable earnings will fall within the range of the targeted rate of return. The agency's advance control over tariff rates minimizes the risk that AT&T will generate unauthorized revenues. The power to call for an accounting and order a refund allows the agency to remedy excessive returns that occur after the fact. Finally if, as here, rates already approved subsequently produce higher than anticipated returns, the FCC can respond by analyzing present conditions to determine if the higher return is appropriate. If not, the Commission can order the carrier to file reduced tariffs targeted to meet the lower rate of return required by current circumstances.

Thus, in the present case, the FCC observed that the tariffs produced a return of 9.25 percent in 1976, confirming that the target limitation on increased revenues operated as anticipated. Hence there was no need to continue the section 204 process. In 1977, the tariffs produced a 9.59 percent return. Only in 1978 did the unchanged tariffs produce the .22 percent surplus.

It has taken the agency six years to come to the conclusion that its policy necessarily allows it to reduce future rates to remedy the situations. Based on the

policy in effect when AT&T filed its tariffs, however, the FCC should have determined whether the conditions in 1978 and thereafter warranted a prospective reduction in rates. The relevant circumstances for analysis would have included the fact that (1) in an inherently imperfect regime, the excess amounted to less than one-fourth of one percent; (2) the 1976 tariff rates produced a return below 10 percent in every year other than 1978; (3) the rate of return for the entire period 1976 to 1980 averaged 9.69 percent; (4) the governing rate of return was implemented in 1976 based on economic conditions obtaining in 1975; and (5) the relevant period for analyzing prospective rates, if the FCC had acted in timely fashion, would have been in 1979 or soon thereafter.

Whatever the outcome of this analysis, the fundamental point is clear. The FCC would have asked whether the overage signaled a need to reset tariff rates based on current conditions. The 1984 order confirms at a minimum that the rate of return established in 1976 continued to apply in 1978. Therefore, had AT&T in fact lowered rates in 1979 in response to the .22 percent excess in 1978, they would have realized a shortfall below even the allowed 10 percent rate of return (i.e., at the unchanged rates, the 1979 annual rate of return was 9.90 percent).

In sum, the FCC cannot cite a single passage in its regulatory decisions forecasting the refund policy announced in 1984. *See* Brief for Respondents at 22-26. The record documents two prior instances in which actual rates exceeded the target rate of return. Most important, the 1984 order—reducing future rates based on past surplus—contradicts the central premise of the FCC's rate-of-return regulation as a forward-looking assessment of capital needs, instead of an historically based estimation of actual costs. In these circumstances, the FCC violated the well-established prohibition against

retroactive application of a newly announced policy. *See Boston Edison Co. v. FPC*, 557 F.2d 845, 849 (D.C. Cir.), *cert. denied sub nom. Town of Norwood, Mass. v. Boston Edison Co.*, 434 U.S. 956 (1977); *FERC v. Triton Oil and Gas Corp.*, 750 F.2d 113, 116 (D.C. Cir. 1984).

B. *Reliance*

The prohibition applies with special force when, as here, the party subject to the change has relied to its detriment on the prior policy. Whereas the majority is unable to find any such reliance, I believe the reliance is self-evident. Prior to today's ruling, AT&T had every reason to believe that section 204 provided the only statutory mechanism for ordering a retroactive refund. The FCC concedes that this section does not apply here. Therefore, the only other provision that could arguably provide such authority, section 4(i) aside,[1] is the section 205 authority to set "just and reasonable [rates] . . . to be *thereafter* observed," 47 U.S.C. § 205(a) (emphasis added); *cf.* the regulatory analog in section 206 of the Federal Power Act, 16 U.S.C. § 824e(a), and section 5 of the Natural Gas Act, 15 U.S.C. § 717d(a).

By long-established principle, these three parallel statutory provisions "bar[] utility refunds for past excessive rates, or the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate." *City of Piqua, Ohio v. FERC*, 610 F.2d 950, 954 (D.C. Cir. 1979); *Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578 (1981); *Indiana & Michigan Elec. Co. v. FPC*, 502 F.2d 336, 345 (D.C. Cir. 1974), *cert. denied*, 420 U.S. 946 (1975). While the majority finds that section 4(i) could support the particular remedy ordered

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[1] "The Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions." 47 U.S.C. § 154(i) (1982).

here in the future, it is evident that prior to this ruling AT&T could reasonably have believed that sections 204 and 205, and the analogs in the electric and gas industry, contained the relevant statutory framework. As the FCC concedes, *see* AT&T Earnings on Interstate and Foreign Services During 1978, 49 Fed. Reg. 49,502, 49,507 (1984), and the panel holds, maj. at 14, this framework provides no authority for the 1984 refund order.

The majority believes AT&T should have foreseen the true novelty here, namely, the location of refund power in the section 4(i) authorization to perform such acts "as may be necessary in the execution of its function." 47 U.S.C. § 154(i). This first use of section 4(i) to authorize the 1984 refund does not void the FCC's construction of the statute. *Bankamerica Corp. v. United States*, 462 U.S. 122, 131 (1983) ("[a]uthority actually granted by Congress . . . cannot evaporate through lack of administrative exercise." (quoting *FTC v. Bunte Bro., Inc.*, 312 U.S. 349, 352 (1941))). It does mean, however, that persons subject to enforcement proceedings can reasonably rely "on what was universally perceived as plain statutory language," *id.* at 133, or, as here, the plain statutory scheme. *See National Classification Comm. v. United States*, 746 F.2d 886 (D.C. Cir. 1984) (agency cannot retroactively expose carriers to antitrust liability for reasonable reliance on a settled prior construction of an agreement).

Other factors independently demonstrate AT&T's reliance. Absent notice of the refund policy, the carrier went five years without a change in its tariff even though it could have increased its revenues in every year except 1978 without exceeding the 10 percent rate of return limit. The increased revenues would have more than offset the $101 million rate reduction ordered here. Moreover, although the agency in 1984 held that conditions in 1978 fell "within the correlative range of economic and

financial market conditions," considered in 1976, 49 Fed. Reg. at 49,506 n.34, a quick perusal of the FCC opinions fixing the appropriate rate of return in a given period indicates the subject admits to less than scientific certainty. For example, the decisions document the multiple assumptions used to compile this deceptively simple rate-of-return figure and the multiple underlying debates among economists over the proper measurement of the cost of debt and equity. *See, e.g.*, 9 F.C.C.2d at 72-86; 38 F.C.C.2d at 226-46; 57 F.C.C.2d at 962-72.

In this context, the FCC's post-hoc determination in 1984 that 1976 economic conditions still prevailed in 1978 does not mean the agency would have necessarily rejected a .22 percent increase in the allowable rate of return if vigorously pressed and documented at the time by AT&T. With such large sums of money at stake, I believe the majority is unduly formalistic when it asserts as fact that AT&T would not have behaved any differently even with explicit knowledge that a .22 percent overshoot in its calculated rate of return would produce a $101 million refund order.

C. *Inherent Remedy*

A final justification relied upon by the FCC, *see* Brief for Respondents at 23, and the majority, maj. at 18, is that the rate-of-return prescription inherently encompasses the remedy of setting a rate of return appropriate to say 1985, but then reducing that rate by a fixed sum (here $101 million plus $77 million in interest) to adjust for past surplus. FCC practice has been otherwise. FCC decisions describe a contrary system. No other regulators have seen fit to follow this system. Indeed, the FCC only began using the word "prescription" in 1973, in a discussion to which it attached no special significance, six years after adopting a policy that "represent[s] no new or essentially different approach" to rate regulation.

9 F.C.C.2d at 116. *See* 42 F.C.C.2d 293, 300 (1973); 51 F.C.C.2d at 625 n.12. To the extent the word has application here, it is to signify that the rate of return prescribes the allowable rate of return. This court said no more in *Nader v. FCC*, 520 F.2d 182 (D.C. Cir. 1975). Now the FCC claims long after the fact that a prescriptive rate-setting regime silently conveys the additional prospect of an enforcement policy reducing prospective rates to remedy past surplus. In these circumstances and in light of the FCC's insistence that rates relate exclusively to current conditions, I believe the Supreme Court has pronounced decisively. The 1984 enforcement scheme "is too unprecedented a departure from the conventions of ratemaking to rest on mere inference." *Transcontinental & Western Air, Inc. v. CAB*, 336 U.S. 601, 607 (1949).

D. *The Rulemaking Order*

The posture of this case would be substantially altered if the FCC were arguing its right to engage in rulemaking in an adjudicatory setting. Yet here we have the anomalous circumstance that the refund order directed at AT&T was expressly a single party adjudication. *See supra* at 2. The subsequent decision to engage in prospective rulemaking conclusively establishes that the FCC has no statutory interest in the outcome of this particular case. *Cf. Triton Oil*, 750 F.2d at 116 ("The Commission may not abuse its discretion by arbitrarily choosing to disregard its own established rules and procedures in a single, specific case."). In the context of *Retail, Wholesale*, the substantive rationale for allowing retroactive rulemaking is sharply diminished.

Moreover, pursuant to the actual rules adopted, *AT&T would most likely not be liable for a "refund" in the instant case.* Specifically, the Commission, in its preliminary rulemaking, recognized the "inability of carriers 'to target their earnings with precision' as a result of

'unpredictable factors.' *The Commission recognized that 'disallowing any earnings 'peaks,' while ignoring the 'valleys,' would tend to induce a systematic bias that would cause a carrier to fall short of its targeted rate of return over the long run.'* " Brief for Respondents, Nos. 85-1778, *et al.* at 11 (citations to record omitted) (emphasis added).

The final rules establish several specific provisions to deal with the inherent fluctuation in return, i.e., the precise issue of this case. *See id.* at 31-34. Significantly, the measuring period for the return is two years, not one. AT&T earned 9.59 percent in 1977 and 10.22 in 1978, which produces a two-year average return of 9.91 percent. Moreover, the two-year provision allows for "mid-course corrections, thereby lessening the possibility that the enforcement mechanism would have to be invoked." *Id.* at 13 (citations to record omitted). AT&T, of course, was given no such opportunity to make corrections in the present case. Indeed, it is startling that under the new rules, AT&T is expressly allowed to file increases if actual earnings are below the prescribed return during the first year. *Id.* at 33. Had AT&T been allowed the benefit of this procedure, it could have raised rates in 1976 (9.25 percent actual), 1977 (9.59 percent), 1979 (9.90 percent), and 1980 (9.90 percent) and still been below the allowable ten percent ceiling. With perfect targeting, AT&T would have earned an additional 1.36 percent, less the .22 percent surplus in 1978 for a net gain of 1.16 percent. If a .22 percent overcharge resulted in a $101 million refund order, AT&T actually could have charged approximately an additional *half-billion dollars* during this period without violating the established, lawful rate of return.

IV. Conclusion

The FCC has the statutory authority to insure that actual rates filed are likely to fall within the required range (by targeting the allowable revenue increment pursuant to section 205), and that the rates in fact do fall within the range (via a section 204 accounting). Over time the FCC can force prospective adjustments in rates by lowering or raising the allowed rate of return, as required by current economic conditions. Notwithstanding this comprehensive program, the majority credits the FCC with a policy that cannot be found in the record. The opinion further ignores the carrier's reliance upon the statutory refund scheme as it existed in 1978, and rejects outright the prospect that hundred million dollar refund orders would sharpen the carrier's interest to earn all revenues to which it was entitled. Finally, the majority ignores the implications of the FCC's subsequent decision to engage in formal rulemaking. Application of well-established retroactivity doctrine requires that the 1984 *Refund Order* be set aside. I respectfully dissent.

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1087

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY,
Petitioners

v.

FEDERAL COMMUNICATIONS COMMISSION AND THE
UNITED STATES OF AMERICA,
Respondents

and consolidated cases

Before: Mikva and Buckley, Circuit Judges

ORDER

[Filed Nov. 2, 1988]

Upon consideration of petitioners' petition for rehearing, it is

ORDERED, by the Court, that the petition is denied.

FOR THE COURT:

CONSTANCE L. DUPRE
Clerk

By: /s/ Robert A. Bonner
ROBERT A. BONNER
Deputy Clerk

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1087

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
Petitioners

v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,
Respondents

and consolidated cases

Before: Wald, Chief Judge; Robinson, Mikva, Edwards, Ruth B. Ginsburg *, Starr, Silberman *, Buckley, Williams, D.H. Ginsburg and Sentelle, Circuit Judges

ORDER

[Filed Nov. 2, 1988]

Petitioners' Suggestion for Rehearing *En Banc* has been circulated to the full court. The taking of a vote thereon was requested. Thereafter, a majority of the judges of the Court in regular active service did not vote in favor of the suggestion. Upon consideration of the foregoing, it is

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* Circuit Judges Ruth B. Ginsburg and Silberman did not participate in this order.

ORDERED, by the Court *en banc*, that the suggestion is denied.

FOR THE COURT:
CONSTANCE L. DUPRE
Clerk

By: /s/ Robert A. Bonner
ROBERT A. BONNER
Deputy Clerk

A dissenting statement of Circuit Judge Starr, in which Circuit Judges Williams and Buckley join, is attached.

A separate statement of Circuit Judge D.H. Ginsburg is also attached.

A separate statement of Circuit Judge Sentelle is also attached.

STARR, *Circuit Judge*, joined by WILLIAMS and BUCKLEY, *Circuit Judges, dissenting from denial of rehearing en banc*: The fundamental issue presented in these cases is of manifest importance. Not only are the economic stakes staggeringly high, but the FCC has expansively asserted a recently discovered power enshrouded for a half century in the mists of the Communications Act of 1934. This recent discovery at 19th and M Streets represents yet another example in the long and dreary line of bureaucratic excesses in our system of limited government. The FCC has, in brief, purported to exercise a power which Congress never conferred upon it; what is worse, the Commission's clawback approach and mandating of the maximum rate of return do violence to well-settled, salutary doctrines, such as the bar on retroactive ratemaking and the filed rate doctrine. In the process, the Commission's ratemaking revolution flies in the teeth of the twin virtues of stability and predictability which rate regulatory regimes are designed to foster.

The errors complained of are, in short, profound. Unfortunately, as the order denying the suggestion indicates, a number of our judges have not been able to participate in evaluating the merits of what I believe to be a compelling demonstration by Comsat and other telecommunications firms that the *New England* majority was badly wrong. This substantial shortage in judicial personnel has virtually foreordained that this issue cannot now be afforded the *en banc* treatment that it so plainly deserves. Under these circumstances, the state of the law in this circuit on a pivotal statutory issue cutting across agency lines can only be regarded as distressingly unsettled until the question arises in a context where the court can truly turn its full evaluative powers to the question at hand.

Separate Statement of Circuit Judge David B. Sentelle: I do not intend by joining in the vote to deny rehearing *en banc* to imply a position on the merits of *en bancing* this controversy. Rather, it appears to me that a case with multiple recusals is a particularly poor vehicle for re-visiting a recurring question of Circuit Law.

UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 85-1087

NEW ENGLAND TELEPHONE AND TELEGRAPH CO., *et al.*,
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v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,
Respondents

and consolidated cases

Before: Wald, Chief Judge; Robinson, Mikva, Edwards, Ruth B. Ginsburg,* Starr, Silberman,* Buckley, Williams, D.H. Ginsburg * and Sentelle, Circuit Judges

ORDER

[Filed Nov. 23, 1988]

It is ORDERED by the Court *en banc*, on its own motion, that the order filed on November 2, 1988, denying petitioners' suggestion for rehearing *en banc* is amended as follows:

(1) The names of the judges are amended by adding an asterisk next to the name of Circuit Judge D.H. Ginsburg as follows:

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* Circuit Judges Ruth B. Ginsburg, Silberman, and D.H. Ginsburg did not participate in this order.

Before: Wald, Chief Judge; Robinson, Mikva, Edwards, Ruth B. Ginsburg,* Starr, Silberman,* Buckley, Williams, D.H. Ginsburg * and Sentelle, Circuit Judges

(2) Insert the name of Circuit Judge D.H. Ginsburg in the fourth sentence from the end of the order, to read as follows:

"* Circuit Judges Ruth B. Ginsburg, Silberman and D.H. Ginsburg did not participate in this order."

(3) Delete the following sentence, in its entirety, from the order:

"A separate statement of Circuit Judge D.H. Ginsburg is also attached."

(4) Delete, in its entirety, the "Separate Statement of Circuit Judge D.H. Ginsburg."

It is FURTHER ORDERED, by the Court *en banc*, that all other aspects of the Court's November 2, 1988 order remain the same.

FOR THE COURT:

/s/ Constance L. Dupre
CONSTANCE L. DUPRE
Clerk

APPENDIX C

FCC 84-567
35285

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

CC Docket No. 79-187

IN THE MATTER OF
AT&T EARNINGS ON INTERSTATE AND
FOREIGN SERVICES DURING 1978

DECISION

Adopted: November 21, 1984 Released: December 11, 1984

By the Commission:

1. This proceeding was initiated as a result of information that indicated that tariffs incorporating compensation to local exchange carriers, interexchange carriers, and AT&T, would result in an earned rate of return for 1978 that would exceed the level authorized by the Commission.[1] At issue is whether the authorized rate of re-

[1] During 1978 AT&T filed monthly reports of interstate earnings that showed earnings ratios in excess of those that had been prescribed in Docket No. 20376, 57 FCC 2d 960 (1976). On December 20, 1978, the General Services Administration wrote to the Acting Chief of the Common Carrier Bureau with respect to AT&T's interstate earnings. On July 20, 1979, the National Citizens Committee for Broadcasting, the Consumer Federation of America, and the Missouri Public Interest Research Group filed a "Petition for Enforcement of Accounting Order" which raised questions concerning AT&T's 1978 interstate earnings. Our action in this proceeding also addresses that petition.

turn for 1978 was exceeded, and if so, the remedial action that the Commission should take. We conclude that the level of interstate revenues that was received by AT&T and the Bell System Companies (hereinafter collectively referred to as "AT&T", unless the context indicates otherwise) during 1978 exceeded the authorized level by $101,000,000. We also establish a remedy by providing for reductions to prospective rates. In a forthcoming order, we will address the 1978 compensation that was received by non-AT&T/BOC carriers that was derived from interstate tariffs that were filed by AT&T.[2]

I. BACKGROUND

2. On January 19, 1976, the Commission voted to prescribe 9.5 percent as the rate of return for AT&T's interstate and foreign services. The Commission also stated that earnings equivalent to an additional 0.5 percent return on AT&T's interstate rate base would be allowed as an incentive for increased productivity and efficiency. A written decision to this effect was released on February 5, 1976,[3] that stated that the Commission would "not require any downward adjustment of AT&T's overall interstate rates provided its overall rate of return does not exceed 10 percent." AT&T filed tariff revisions on January 29, 1976 that were represented as having been designed to produce the prescribed 9.5 percent rate of return. The Commission suspended the revised rates for one day and subjected those rates to an accounting order.

3. With the increased rates in effect for only part of the year, AT&T reported an overall interstate rate of return of 9.25 percent for 1976. During 1977, AT&T's measurement of its earned rate of return increased to

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[2] *See* paras. 17, 19, and 25, *infra*.

[3] *AT&T Rate of Return*, Docket No. 20376, 57 FCC 2d 960, 973 (1976).

9.59 percent. AT&T's Interstate Monthly Reports ("IMR 1") for the first nine months of 1978 showed a cumulative annual rate of return of 10.42 percent. This prompted the Common Carrier Bureau to initiate an internal review of AT&T's earnings. On December 20, 1978, the Acting Chief of the Common Carrier Bureau formally requested information from AT&T.[4] In response to the Bureau Chief's letter, AT&T stated that its 1978 rate of return was 10.02 percent when calculated in accordance with the accounting changes concerning plant under construction that had been adopted in Phase II of Docket No. 19129.[5] It also stated that changes in economic conditions since the 1976 prescription justified an increased earnings level.[6]

4. AT&T's IMR 1 dated January 22, 1979 for calendar year 1978 showed a 10.22 percent rate of return on AT&T's interstate and foreign services.[7] The Acting

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[4] Letter to William R. Stump, American Telephone and Telegraph Company, from the Acting Chief, Common Carrier Bureau, December 20, 1979.

[5] *Phase II Final Decision and Order in Docket No. 19129*, 64 FCC 2d 1 (1977). *See Memorandum Opinion and Order In the Matter of American Telephone and Telegraph Co.*, 72 FCC 2d 1 (1979). At the time of the Bureau Chief's letter, AT&T had a petition before the Commission that subsequently was approved at a public meeting on December 21, 1978. The effect of granting AT&T's request was to increase the measurement of AT&T's earned rate of return to 10.22 percent. A more extensive discussion of the treatment of interest on plant during construction, and its relationship to the measurement of AT&T's 1978 interstate earnings, is contained in Appendix A.

[6] Letter to Acting Chief, Common Carrier Bureau, from William R. Stump, Assistant Vice President, AT&T, January 19, 1979.

[7] The revenue required to produce an after tax rate of return of 10.0 percent for 1978 is $101.0 million less than the revenues shown on the IMR 1. Letter to Glenn DeChabert, Common Carrier Bureau, from T.E. Lawrence, AT&T, October 26, 1979. AT&T Comments at para. 64. This dollar measurement has not been contested by

Chief of the Common Carrier Bureau subsequently asked AT&T to explain the difference between the 10.02 percent figure cited in its letter of January 19, 1979 and the 10.22 percent figure shown on the IMR 1 which was dated January 22, 1979.[8] AT&T stated that the 10.02 percent figure nor 1978 had been calculated in accordance with accounting rules for interest during construction that actually were not scheduled to become effective until January 1, 1979. AT&T further stated that it had used this measure of rate of return because it appeared to be a better indicator of future earnings levels than the unadjusted figure due to the fact that those accounting changes would tend to lower the measurement of the earned rate of return somewhat in future years.[9]

5. On September 18, 1979, the Commission adopted a Notice of Inquiry in this proceeding to examine the policy and earnings measurement issues that had arisen from AT&T's 1978 interstate operations. We requested comments on five issues: (1) Is review of AT&T's earnings on a calendar year basis appropriate in determining whether AT&T has complied with a rate of return prescription? (2) If a calendar year assessment is not appropriate, what interval should be used? (3) What is the correct measurement of AT&T's earned rate of return during 1978? (4) Has AT&T exceeded its prescribed rate of return, and if so, by what dollar amount? (5) What remedial action should the Commission take if AT&T's earned rate of return has exceeded the prescribed level? [10]

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any of the parties to this proceeding, and there is no question of fact incident thereto.

[8] Letter to William R. Stump, Assistant Vice President, AT&T, from Chief, Common Carrier Bureau, April 20, 1979.

[9] Letter to Chief, Common Carrier Bureau, from William R. Stump, Assistant Vice President, AT&T, May 3, 1979.

[10] *Common Carrier-Interstate and Foreign Earnings* (CC Docket No. 79-187), 75 FCC 2d 412 (1979).

6. Comments in response to those issues were filed by AT&T, the United States Independent Telephone Association (USITA), the United States Office of Consumer Affairs (USOCA), the General Services Administration (GSA), and the Massachusetts Public Interest Research Group (Massachusetts PIRG). Joint Comments were filed by the National Citizens Committee for Broadcasting, the Consumer Federation of America, the Missouri Public Interest Research Group, and the California Department of Consumer Affairs, (hereinafter collectively referred to as "NCCB"). AT&T opposed refunding any revenues that resulted in earnings in excess of 10.0 percent.

7. AT&T argued, *inter alia*, that the Commission did not have authority to order refunds of 1978 revenues. AT&T also contended that if the Commission had legal authority to order refunds, refunds were not warranted as a matter of discretion given AT&T's earnings history and then existing conditions in the financial markets. In addition, AT&T stated that its 1978 rate of return for all interstate services was not the 10.22 percent shown for 1978 on the IMR 1 but rather 10.09 percent because the 1978 IMR 1 reflected only the revenues, expenses, and investment that were associated with services provided at uniform nation-wide rates.[11] USITA also opposed any refund of AT&T's 1978 revenues, arguing that the Commission only has authority to prescribe actual rates, not a rate of return. In addition, USITA contended that the reasonableness of a given rate of return varies with changing economic and financial conditions.

8. GSA supported refunding those revenues that caused AT&T's 1978 earnings to exceed a 10.0 percent

[11] A further reduction of 20 basis points (to 9.89 percent) was viewed by AT&T as being preferable to the 10.09 percent figure because the 9.89 percent measurement reflected "full implementation of the Commission's Phase II decision in Docket No. 19129." AT&T Comments at 41.

rate of return. USOCA also supported refunds after having noted that the Commission's 1976 prescription Decision had placed AT&T on notice that 10.0 percent was the maximum allowable rate of return. Both GSA and USOCA argued that 10.22 percent was the correct figure for AT&T's 1978 earned rate of return. NCCB also supported refunds, but stated that the amount of the overage should be determined through evidentiary hearings. The Massachusetts PIRG filed a letter suggesting that AT&T's 1978 earnings in excess of 10.0 percent be used to establish a consumer action group to monitor AT&T.

9. AT&T, GSA, USOCA, and NCCB filed reply comments. AT&T argued that GSA, USOCA, and NCCB had failed to discuss the central issue in the case, erroneously assuming that the 10.0 percent figure constituted a ceiling for AT&T's rate of return despite changing economic conditions. Responding to this contention, GSA, USOCA, and NCCB argued that a rate of return prescription remains binding until changed by the Commission after a full hearing.[12]

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[12] AT&T also argued that a time period other than a calendar year should be used for assessing compliance with a rate of return prescription. In its opposition the USOCA referred to *Federal Power Commission v. Hope Natural Gas Co.*, 320 U.S. 591, a frequently cited decision that refers to the annual returns that the Hope Natural Gas Co. was to achieve. *Id.* at 605. USOCA also observed that to use any measure other than the calendar year would ignore established regulatory standards. USITA stated that the exact earned (*"ex post"*) rate of return of a common carrier can only be ascertained at the end of the carrier's fiscal year because it is only "at the end of the fiscal year [that] actual expenses can be subtracted from actual revenue and the result divided by the actual rate base for the year." We agree with USITA to the extent that the fiscal year of the carrier should control, as contrasted with the calendar year. The revenues, expenses, and assets of common carriers are typically subject to independent audit on a fiscal year basis, with income tax liabilities (and filings) being based upon data that are collected during each tax payer's fiscal year. Further, the

II. DISCUSSION

A. *Assessment of Measurements of AT&T's 1978 Interstate Rate of Return*

10. Including its comments in this proceeding, AT&T has provided five earned rate of return figures for 1978. The Interstate Monthly Report No. 1 ("IMR 1"), that AT&T filed with this Commission as its statement of earnings on interstate and foreign operations, reported that AT&T's earned rate of return for the calendar year ending December 31, 1978, was 10.22 percent. On June 29, 1979, AT&T submitted a "1978 Annual FDC Report" that stated that AT&T's 1978 earned rate of return on its interstate and foreign services was 10.1 percent. On November 13, 1979, AT&T filed comments stating that the 10.1 percent was really 10.09 percent.[13] The 10.02 percent measurement was supplied by AT&T on January 19, 1979, in a letter from Mr. William R. Stump to the then Acting Chief of the Common Carrier Bureau which Mr. Stump further clarified by a letter to the Chief of the Common Carrier Bureau dated May 3, 1979.

11. The five different figures that AT&T provided are based upon three essentially separate concepts. The IMR 1 stated that the earned rate of return was 10.22 per-

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Securities and Exchange Commission's annual corporate reporting requirements (including annual reports to shareholders) are based upon the fiscal year, with the consequence that the adoption of the fiscal year for assessments of AT&T's earned rate of return would assist investors, the public, and governmental entities in reviewing AT&T's operating results on a consistent basis. Accordingly, since AT&T's 1978 fiscal year was coincident with the calender year, we conclude that we will confine our analysis to those issues that are raised by earnings that were achieved during AT&T's fiscal year ending December 31, 1978.

[13] In the second footnote on page 43 of AT&T's comments, AT&T stated: "[t]he 10.1 percent was arounding of a 10.09 percent, so that the excess is only 9 basis point."

cent. AT&T's 1978 FDC 7 Report, which was based upon data for the month of June, 1978, stated that the earned rate of return was 10.09 percent (or 10.1 percent). AT&T also contended that the preceding measurements should be reduced by twenty basis points (0.20 percent) to reflect the Commission's decisions in Phase II of Docket No. 19129. We reject this later adjustment of twenty basis points for reasons that have been expressed in our decisions in other proceedings.[14]

12. We thus turn to the adjustments that were made to the 10.22 percent reported in the December, 1978, IMR 1 to arrive at the 10.09 percent that AT&T submitted in its "1978 Annual FDC Report" as its earned rate of return for 1978. By transmittal letter dated June 29, 1979, AT&T filed a "1978 Annual FDC Report." That report, which relied upon data for the *month* of June, 1978, purported to show the rate of return that AT&T had earned during the 1978 *calendar year* on each of its interstate services. Volume 2 of that report developed a "recast" of the IMR 1 that revised AT&T's December, 1978, IMR 1 to show an earned rate of return of 10.09 percent on AT&T's interstate services. The "recast" contained interstate investment, expenses, and revenues that had purportedly not been included in the prior IMR 1 reports that AT&T had supplied to this Commission. Specifically, AT&T stated that the IMR 1 had not included investment, revenues, or expenses that were incident to the provision of interstate services at "non-uniform rates."[15] Several aspects of AT&T's approach

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[14] At this point it is sufficient to note that we have already ruled upon this matter. *See Memorandum Opinion and Order In the Matter of The American Telephone and Telegraph Company*, 72 FCC 2d 1 (1979), and the discussion contained in Appendix A, *infra*.

[15] In its "1978 Annual FDC Report," AT&T described "services provided at non-uniform rates" as being the use of its facilities pursuant to BSOC Tariffs Nos. 3 & 4, Western Union Contracts Nos. 1 & 2, and the use of its facilities by other common carriers. In its comments in this proceeding, AT&T stated that the 10.22

require that we not accord to the "1978 Annual FDC Report" adjustments the same weight that we attach to the figures that were contained in the December, 1978 IMR 1. For example, if "recasting" were required, actual data for the 1978 calendar year should have been employed for "recasting" rather than data that were selected for the month of June.[16] Second, no data have been presented that credibly established that June, 1978, is a month that accurately represents the investment and/or expenses that were associated with the provision of facilities to the OCCs.[17] In this regard we concur in USITA's assessment that the measurement of excess interstate revenues for the fiscal year of a carrier requires *actual* interstate investment, expenses, and revenues for the entire fiscal year.

13. More important, however, is the fact that *this Commission has consistently relied upon the Interstate Monthly Report No. 1 in assessing AT&T's interstate earnings.* AT&T has supplied the IMR 1 reports to this

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percent measurement contained in the December, 1978, IMR 1 has "[e]xcluded, *for example*, . . . revenues, expenses and investment associated with interstate facilities provided to other common carriers, foreign exchange channels between contiguous exchanges and less than fourteen miles in length, and link facilities for air-ground and coastal harbor service, and CATV channel service." (emphasis added)

[16] Presumably data for each of the twelve months in 1978 were available to AT&T during the Spring of 1979, given the fact that AT&T's IMR 1 for the month of December, 1978, states that it was issued on January 22, 1979.

[17] Additional issues arise with respect to the treatment of the adjustments that were made for facilities incident to the provision of services under BSOC Tariff Nos. 3 & 4 and Western Union Contracts Nos. 1 & 2. The Western Union Contracts Nos. 1 & 2 terminated on September 30, 1978, which would suggest that adjustment would be necessary to reflect the fact that no further activity under those contracts occurred during the months of October, November, and December, 1978.

Commission for approximately twenty-eight years as its summary of its interstate and foreign services operations. On July 25, 1979, AT&T, in response to specific questions as to measurement of AT&T's earned rate of return on interstate services for the calendar year 1978, stated:

> AT&T reports monthly to the Commission the interstate rate of return consistent with the Commission's past decision as to the appropriate elements of revenues, expenses, taxes and net investment to be used in the calculation of the rate of return. *The report on which the interstate rate of return is shown is the interstate Monthly Report No. 1.* —
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> [t]he rate of return of 10.22% shown on the December 1978 Interstate Monthly Report No. 1 is the rate or return for 1978 based on the Commission's directives appropriate to that year, including the December 21 [IDC] decision mentioned above. (Letter from Mr. William Stump to the Chief of the Common Carrier Bureau, dated July 25, 1979.) (emphasis added)

14. On September 27, 1979, additional information was requested from Mr. Thomas Lawrence, a member of AT&T's FCC Financial and Accounting Matters Staff, as to the measurement of the revenues that AT&T had received during 1978 that were in excess of the 10.0 percent specified in our decision in Docket No. 20376. Specifically, Mr. Lawrence was asked to

> [p]lease state: (1) what total revenues for 1978 would have been required to achieve an after tax rate of return of 10.00 percent and (2) the income tax rates (federal, state, and, if applicable, municipal) which have been applied to any revenues *which have resulted in earnings in excess of the 10.00% rate of return specified in Docket No. 20376.* (emphasis added)

In response thereto, Mr. Lawrence stated:

> Pursuant to your request, we have computed the revenues that would have been required to achieve an after-tax rate of return of 10.0% for the year 1978. The data utilized in the attached analysis indicates that *the revenues required to achieve a 10.0% return would have been $101.0 million less than the revenues shown on the Interstate Monthly Report No. 1 for the year 1978* as issued by AT&T on January 22, 1979. . . . (Letter from Mr. Thomas Lawrence, AT&T, dated October 26, 1979) (emphasis added).

15. In its comments in this proceeding, AT&T has also stated that an earned rate of return measurement of 10.22 percent would result in $101.0 million of revenues in excess of 10 percent.[18] In light of the information that is before us, we conclude that AT&T's 1978 interstate and foreign services revenues exceeded the level that was authorized by $101,000,000.[19]

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[18] AT&T Comments, para. 64.

[19] In the case before us here, there is no issue of fact that requires a trial type evidentiary hearing. We have relied upon the IMR 1 that AT&T has supplied to this Commission. AT&T's alternative measurements of its earned rate of return during 1978 (*Viz.* 9.89 percent, 10.02 percent, 10.09 percent, 10.1 percent) have been rejected on the basis of our earlier decisions with respect to IDC (9.89 percent, 10.02 percent), and our assessment of the "1978 Annual FDC Report" (10.09 percent, 10.1 percent). The resolution of these measurement issues depends either upon the meaning of our prior decisions (see Appendix A, *infra*), or upon the fact that we accord no weight to the measurement of AT&T's rate of return that is contained in AT&T's 1978 Annual FDC Report. As AT&T noted in its Opposition to the NCCB petition, "the pertinent data are already before the Commission in reports routinely filed as well as previous correspondence . . . ." AT&T Opposition at 3, n.* (filed August 2, 1979).

16. The $101 million in excess revenues that AT&T received [20] during 1978 are exclusive of interest. In prior refund cases, it has been our policy to award simple interest at the rate that has been computed by the Commissioner of the Internal Revenue Service. Although comments suggested that another interest rate be adopted, we see no compelling reason to depart from that well established practice here.[21] It has also been the Commission's practice to compute interest from the date of the complaint.[22] In this case, however, we have determined that the final date for the determination of AT&T's excess revenues is at the conclusion of AT&T's fiscal year on December 31, 1978. Accordingly, interest shall be calculated from that date, rather than from the December 20, 1978, date of the GSA letter. The Internal Revenue Service interest rates that were applicable from January 1, 1979 are: 6 percent from January 1, 1979, through January 31, 1980; 12 percent from February 1, 1980, through January 31, 1982; 16 percent from January 1, 1983, through June 30, 1983; 20 percent from February 1, 1982, through December 31, 1982; 11 percent from July 1, 1983 through December 31, 1984; and 13 percent from January 1, 1985 to June 30, 1985.[23]

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[20] AT&T's reported gross revenues were based upon tariffs that included connecting and concurring carriers that received revenues through the division of revenues and settlements processes.

[21] The National Citizens Committee for Broadcasting, the Consumer Federation of America and the Missouri Public Interest Research Group requested that interest be accrued at the prime rate. The USOCA supported that request.

[22] *Teleprompter Inc.* v. *Chesapeake and Potomac Tel. Co.*, 79 FCC 2d 232, 238-39 (1980), *recon.* 85 FCC 2d 23 (1981); *Georgia Power Co.* v. *Columbus Cablevision, Inc.*, FCC 84-100 (released March 20, 1984) at para. 9 n.9.

[23] Rev. Rul. 83-171, 1983-47 I.R.B. 7; Rev. Rul. 84-66, IRB 1984-18 (April 30, 1984). *See* references cited in para. 16 n.22, *supra*.

B. *Restitution*

17. The Notice of Inquiry requested comments on the action that this Commission should take when the earned rate of return exceeds the rate that has been authorized. Information in response to that request suggests that the mechanism that entails the least administrative expense would require the imposition of a temporary discount upon interstate services for a period that is sufficient to reduce carrier revenues by the amount that is to be restored to interstate ratepayers. During the time that has elasped since comments were received in this proceeding, the Bell System Operating Companies have been divested from AT&T, the Division of Revenues process has terminated, access charges have been implemented, and earlier settlements procedures have been supplanted by the NECA administered distribution of access charges revenues under Part 69 of the Commission's rules.[24] Whatever weight might properly be ascribed to the conclusion that, in a pre-divestiture environment, temporary discounts on services are less expensive and more efficiently administered than cash refunds has added weight in the post-divestiture environment. In structuring an appropriate remedy, this conclusion is particularly compelling in light of the joint nature of the interstate services that were provided by AT&T, the Bell System Operating Companies, and the independent telephone companies during 1978. During that period, local exchange and other connecting carriers that received revenues that flowed from the provision of services pursuant to AT&T's interstate and foreign services tariffs also shared in aggregate revenues that were excessive. Traditional concepts of equity would, therefore, require that those entities that received excess revenues proportionately share the burden of restoring those revenues to the subscribrs from whom they were received.[25]

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[24] 47 C.F.R. § 69.601 et seq.

[25] Section 201(a) of the Communications Act empowers the Commission, after opportunity for hearing, to establish the division

18. Effecting restitution has been further complicated by the fact that it is virtually impossible to achieve a "direct targeting" of the amounts that should be refunded to particular recipients. Since 1978, ratepayers have died, changed names, and changed addresses. Corporations and other entities having *de jure* status as ratepayers during 1978 have been dissolved, estates have been liquidated and distributed, conservators have been appointed, and trustees in bankruptcy have become successors in interest to rights of bankrupt ratepayers in refunds. Moreover, even if each element within the class of 1978 ratepayers were still in existence and identifiable at ascertainable addresses, it would still not be possible to allocate the amount of 1978's excess revenues, with accrued interest, that should be directly refunded to each of those ratepayers without additional proceedings that would be extensive and time consuming. Also, as we have heretofore observed, we cannot conclude, on the basis of AT&T's 1978 FDC study, that the proportions of the excess revenues that would be allocated to each tariffed service offering during 1978 would be correct.[26]

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of charges among common carriers that engage in the joint provision of interstate and foreign telecommunications services. 47 U.S.C. § 201(a) (1982). Section 201(b) requires that all charges "in connection with such communication service shall be just and reasonable," and "any such charge . . . that is unjust or unreasonable is hereby declared to be unlawful . . . ." 47 U.S.C. § 202(a) (1982). We have concluded that AT&T's 1978 interstate tariffs yielded excessive revenues to the providers of those services. As a consequence, it is not inappropriate to adjust the prospective division of charges among those carriers by their proportionate shares of the excess revenues that were received during 1978. We are herewith instituting the hearing that is required by Section 201(a) in the context of tariff revisions that we have required. *See* para. 25, *infra*. We recognize, in structuring the remedy that is contained herein, that the record in this proceeding is inadequate to permit a quantitative assessment of the restitution obligations of the independent telephone companies that participated in revenues that were derived from AT&T's 1978 tariffs.

[26] Para. 12, *supra*.

19. We have thus concluded that restitution can best be accomplished through a mechanism that will permit us to apply 1978's excess revenues, with accrued interest, to benefit subscribers utilizing the interstate and foreign telecommunications services of AT&T and its connecting and concurring carriers.[27] Accordingly, we direct AT&T to reduce its estimate of its 1985 revenue requirement by its proportionate share of 1978's excess revenues (includ-

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[27] *See Bebchick v. Public Utilities Commission*, 318 F.2d 187, 203-04 (D.C. Cir. en banc), *cert. denied*, 373 U.S. 913 (1963) (opinion permitting utility commission to fashion relief to benefit a class of ratepayers where individual ratepayers who had been overcharged could not be identified). In this case, we could have ordered an immediate discount. However, we have recently imposed revisions to interstate tariffs for switched services and have been conducting an extended review of the private line and special access service tariffs. Additional revisions to reflect changes in assets, expenses, and patterns of demand in exchange access tariffs will be necessary periodically. Because the imposition of unnecessary administrative expense is undesirable, we have concluded that it will be more efficient to address the revenue requirement adjustments that we have required in the context of tariff revisions that will be occuring during 1985. This decision is based upon the fact that we have previously established an orderly procedure for the annual revision of exchange carrier customer line charges, that provides for exchange carrier filings that are to have a scheduled effective date of June 1. *See* Section 69.3 of the Commission's Rules. Those revisions would ordinarily require changes in AT&T's interexchange tariffs, that would require an assessment of AT&T's supporting documentation. As a consequence, it would be administratively more efficient and less expensive to ensure that appropriate modifications have been made to interstate tariffs during the period that has been scheduled for that process, rather than providing for an additional round of tariff modifications and review on top of those that have been required in the context of our most recent orders. We have also concluded that it is not feasible to disproportionately allocate 1978's excess revenues, with accrued interest, among categories of interstate services on the basis of AT&T's 1978 FDC Report (see para. 12, *supra*). At this point, we feel that the administrative, technical, and data complexities, that are associated with effecting restitution in a timely manner, require that we adopt the approach that is contained herein.

ing accrued interest),[28] and we further direct that the NECA shall reduce the estimated 1985 carrier common line pooled revenue requirement by the balance.[29]

C. *Legal Authority*

20. After a full hearing on the record, the Administrative Law Judge entered an Order in Docket No. 20376 that provided that AT&T's interstate earnings were not to exceed 10.0 percent.[30] After expressly affirming the decision of the Administrative Law Judge, the Commission stated that AT&T's earnings were "not to exceed

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[28] The "Plan of Reorganization" that implements the "Modification of Final Judgment" provides that contingent liabilities that relate to interstate rates be apportioned on the basis of "relative investment devoted to interstate services as of the effective date of divestiture (as calculated in accordance with the FCC-prescribed Separations Manual in effect on the date of divestiture), adjusted to reflect the assignment of assets under this Plan of Reorganization (CPE and InterLATA assets to AT&T, and intraLATA assets to the BOCs)." "Plan of Reorganization", filed in *United States v. Western Elec. Co. & AT&T*, C.A. No. 82-0192 (D.D.C., filed December 16, 1982) at 188. We find that such an allocation would be a reasonable and equitable division of the restitution obligations of the exchange and interexchange carriers.

[29] Interest on AT&T's pro rata share of the $101,000,000 shall be accrued from January 1, 1979, to the date upon which AT&T files tariff revisions that reflect the reductions in revenue requirements that have been ordered herein. The aggregate reduction in revenue requirements is to be allocated among the estimated revenue requirements for each service offering by a constant proportion (*e.g.*, the revenue requirement of each service offering shall be reduced by a fraction that is equal to AT&T's total restitution obligation divided by AT&T's total 1985 interstate revenue requirement). Interest on the exchange carrier portion of the restitution obligation shall be completed from January 1, 1979, and shall conclude on the date that NECA files 1985 exchange carrier common line charges that reflect the restitution obligation that we have imposed today.

[30] *AT&T Co.* (Docket 20376), 57 FCC 2d 979, 1005 (1975).

10 percent",[31] and further stated that it would "not require any downward adjustment of AT&T's overall interstate rates provided its overall rate of return does not exceed 10 percent." [32] AT&T did not, however, seek during 1978 to modify the rate of return prescription that AT&T now contends had been vacated by rapidly changing economic circumstances. Nor did this Commission or any court modify, during 1978, the Docket No. 20376 prescription orders. After receiving evidence during 1980, we did prescribe an interim rate of return of 10.5 percent based upon the preliminary evidence that was then before us.[33] At that time we took care to point out that the Commission's Docket No. 20376 prescription orders had not lapsed, and that changes in AT&T's cost of capital could not "simply be determined by reference to changes in economic conditions without a hearing. Thus, we note that general fluctuations in the economy do not, as AT&T implies, weaken or invalidate an outstanding prescription such that a carrier may freely exceed it by filing increased rates." [34] The proper proce-

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[31] *AT&T Co.* (Docket 20376), 57 FCC 2d 960, 973 (1976).

[32] *Id.*

[33] *See* AT&T Petition for Determination of Fair Rate of Return in CC Docket No. 79-63 (filed March 8, 1979). *AT&T*, 78 FCC 2d 661, 668-70, 672 (1980). Based in large measure upon information that was provided with respect to economic conditions during 1981, we subsequently concluded that AT&T's prescribed rate of return should be increased to 12.75 percent. *AT&T*, 86 FCC 2d 221, 251 (1981).

[34] *AT&T*, 78 FCC 2d at 666 n.7. Although AT&T contends that economic conditions during 1978 were sufficiently different to have vacated the 1976 prescription, we do not perceive AT&T's factual predicate to have been well founded. Our assessment of economic and financial market conditions that are of public record with respect to 1978, as well as AT&T's interstate earnings during 1978, reaffirms our conviction that AT&T's prescribed rate of return was within the correlative range of economic and financial market conditions that we considered at the time of the rate of return prescription in early 1976.

dure for a carrier who contends that an outstanding order is improper is to petition the Commission to modify that order.[35] During 1978 AT&T did not conform to the Commission's procedural rules by seeking an order that would have vacated the 1976 prescription order. Accordingly, there is no statutory basis that would lead to the conclusion that the 1976 prescription was not in full force and effect during 1978.[36]

21. We next turn to an argument that was raised by USITA. In discussing the Commission's authority under Section 205(a), USITA stated "[t]he FCC accepted the rates filed by AT&T in 1976. These rates became lawful rates, and AT&T could charge neither greater nor lesser rates. Yet this is precisely what the Commission would be doing in ordering refunds for 1978."[37] In essence, USITA appears to contend that the interstate tariffs under which AT&T was providing service during 1978 were "lawful rates." In this regard, several observations are in order. First, the Commission had never made an affirmative finding that any of AT&T's tariffed charges during 1978 were "just and reasonable" within the meaning of the Communications Act. Second, tariffed charges of AT&T that were in effect during 1978 had been found by this Commission to be unlawful (see Appendix B, *infra*, and references cited therein). The continuation of those services was permitted because the detrimental effects that would have resulted from a disruption in the provision of those services outweighed the harm that would result from the continued provision of those services at rates that had not been adequately jus-

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[35] *See* Sections 1.2, 1.106, and 1.401 of the Commission's Rules, 47 CFR §§ 1.2, 1.106, and 1.401 (1978). Commission orders continue in force until the Commission or a court of competent jurisdiction issues a superseding order. 47 USC § 408 (1978).

[36] *See AT&T*, 78 FCC 2d at 665-70.

[37] USITA Comments at 5-6.

tified. We did not, however, intend that AT&T's charges would result in revenues that exceeded the limit that we prescribed in Docket No. 20376.[38] USITA's contention that AT&T's interstate charges during 1978 were *ipso facto* lawful because they were filed at this Commission is incorrect. It is clear under *Arizona Grocery v. Atchison, Topeka, and Santa Fe Railway Co.*, that rates that become effective may subsequently be found to have violated statutory standards.[39] It is also clear under the Communications Act that a carrier is under an affirmative duty to revise its rates to conform to outstanding prescription orders.[40]

22. Because Section 205(a) does not expressly contain the word "refunds", USITA further contends that any Commission action pursuant to a Section 205(a) prescription could not embrace refunds as a mechanism for

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[38] *AT&T*, 57 FCC 2d 960, 973 (1976); *AT&T*, 78 FCC 2d at 667. *See also* Appendix B, *infra*, and citations contained therein. The difficulties that the Commission was encountering with respect to AT&T's tariffs are described in *Docket No. 18128*, 61 FCC 2d 587 (1976), *recon.*, 67 FCC 2d 1441 (1978); *Notice of Inquiry in CC Docket No. 79-245* (In the Matter of American Telephone & Telegraph Co. Manual and Procedures for Allocation of Costs), 73 FCC 2d 629 (1979); *WATS*, 66 FCC 2d 9, 51-56 (1977), *recon.*, 69 FCC 2d 2031 (1979); *DDS*, 67 FCC 2d 1195, 1229-30 (1978), *recon.*, 70 FCC 2d 616, 630-33 (1979). To the extent that services with associated charges that have been found to be unlawful have been provided through the use of plant that has been jointly used in the provision of other services at charges that have not been determined to be "just and reasonable", we confront a situation that, in the absence of enforcement of the overall rate of return prescription, would potentially permit carriers to achieve unlimited rates of return unless this Commission were to terminate the provision of those services.

[39] *Arizona Grocery* v. *Atchison, Topeka & Santa Fe Railway Co.*, 284 U.S. 370, 384 (1931). *See Carterfone*, 13 FCC 2d 420, *recon. denied*, 14 FCC 2d 571 (1968).

[40] Section 205(a) of the Communications Act of 1934, as amended, 47 U.S.C. § 205(a) (1978) (Commission may "prescribe what will be . . . thereafter observed. . . .").

remediation. While Section 205 does not specifically provide for the enforcement of Commission prescriptions through refund orders, Section 4(i) gives the Commission broad authority to "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this Act, as may be necessary in the execution of its functions." [41] In *Nader v. FCC*, the Court expressly recognized that the power to order refunds is inherent in the Commission's prescription authority.[42]

III. ORDERING CLAUSES

23. IT IS ORDERED That the GSA and NCCB petitions are granted to the extent stated in the rulings and procedures that have been adopted herein and are, in all other respects, denied.[43]

24. IT IS FURTHER ORDERED That restitution shall be effected as provided herein, and that changes in exchange carrier rates that implement this order shall be reflected in AT&T's estimated revenue requirements.

25. IT IS FURTHER ORDERED pursuant to Sections 4(i)-(j), 201, and 202 of the Communications Act, That comments may be filed within twenty(20) days from the date of each tariff filing that implements this Order, and reply comments may be filed within ten (10) days thereafter.

26. IT IS FURTHER ORDERED That the Secretary shall cause this decision to be published in the Federal Register.

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[41] 47 U.S.C. § 154(i) (1978). With respect to the relationship between Section 4(i) and Section 205(a), the Court in the *Nader* case stated that the "discretion that must be afforded the Commission in the exercise of its ratemaking power is enhanced by Section 4(i) of the Communications Act . . ." *Nader v. FCC*, 520 F.2d 182, 203 (D.C. Cir. 1975).

[42] *Nader v. FCC*, *supra*, at 204-05 n.25.

[43] *See AT&T Co.* (Order Instituting Hearing), *supra*, at 690 n.4.

27. IT IS FURTHER ORDERED That the Secretary shall, by registered mail, serve a copy of this decision and notice of hearing upon the American Telephone and Telegraph Company and each of the Bell System Operating Companies in accordance with Sections 416 and 413 of the Communications Act of 1934, as amended, and shall enter proof of service in the docket in this proceeding.

28. IT IS FURTHER Ordered that the Secretary shall transmit a copy of this order to the NECA.

FEDERAL COMMUNICATIONS
COMMISSION
WILLIAM J. TRICARICO
Secretary

APPENDIX A

Interest During Construction

1. In correspondence with the Common Carrier Bureau, and in its comments in this proceeding, AT&T has asserted that the earned rate of return measurements that AT&T reported in the IMR 1 and the 1978 Annual FDC Report should be reduced by 0.20% on the basis of "full compliance" with Docket 19129 (Phase II). In the interest of brevity, those adjustments shall be referred to hereinafter as either the "Interest During Construction" or "IDC" adjustments. The 9.89% measurement of AT&T's earned rate of return for 1978 results from the deduction, by AT&T, of 1978's Interest During Construction from the revenues that AT&T's employed in presenting the 10.09% 1978 earned rate of return figure that was contained in AT&T's FDC Report. Similarly, the 10.02% measurement results from deducting IDC from the 10.22% figure that AT&T filed in its IMR-1 Report for December, 1978. To understand the nature of AT&T's contentions it is necessary to review "IDC" concepts and our decisions with respect to IDC from the ratemaking perspective that is relevant here. Subsequent paragraphs in this Appendix discuss IDC, our decisions with respect to IDC, AT&T's correspondence with respect to IDC, and the measurement of AT&T's earned rate of return during 1978.

2. When a utility constructs plant, the construction of the plant is frequently, although not necessarily, financed through the issuance of interest bearing debt. Inclusion of the interest that was incurred to finance the plant construction could result in "double counting" [1] and

[1] The "double counting" would occur as a consequence of allowing the carrier to earn its allowed rate of return (cost of capital) on the funds which were being used for constructing plant, while, at the same time permitting the carrier to accrue "interest during construction" which the carrier is subsequently permitted to recover from ratepayers.

therefore a double recovery to the carrier if the plant that was under construction were also included in the carrier's rate base for allowed rate of return measurement purposes. As a hypothetical example of this possibility, assume that during 1978 a carrier had $573,478,000 of telephone plant under construction and had incurred $46,786,000 in interest during 1978 to finance that plant while it was under construction. If that carrier were permitted to earn an allowed rate of return of 10% on the plant under construction in its revenue requirements *for that year*, and also receive IDC, the carrier would have been permitted to earn $104,133,000 [2] or 18.16% [3] of that investment as compared with the allowed rate of return of 10%.

3. The issue that AT&T raised in its letters of January 19, 1979, May 3, 1979, and in its comments with respect to IDC had its genesis in our consideration of AT&T's network capacity in the *Phase II Final Decision and Order in Docket No. 19129*, 64 FCC 2d 1, 44-60 (1977). At that time, we noted that our practice had been to "[i]nclude plant under construction in the rate base and charge interest during construction. The interest during construction is included in income for ratemaking purposes and is added to the construction work in progress to be included in utility plant when the construction work is placed in service." *Id.* at 56. An explanation of that treatment for rate making purposes will help to clarify the background that underlies AT&T's proposed adjustment.

4. Upon occurrence of the condition that the constructed plant is actually placed in service,[4] AT&T has

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[2] ($573,478,000) (.1) + $46,786,000 = $104,133,000.

[3] $104,133,000/$563,478,000 = .1816, or 18.16%.

[4] See *Phase II Final Decision and Order in Docket No. 19129*, 64 FCC 2d 1 46-53, 56-62 (1977).

been permitted to add IDC to the cost of that constructed plan, which, in turn, was then included in AT&T's rate base and depreciation expense for ratemaking purposes. To avoid "double counting", in the period(s) prior to the constructed plant's actual commitment to service (and subsequent thereto), we required, for ratemaking purposes, that while the plant was being constructed (termed "construction work in progress") the interest that was being incurred on the construction be added to the revenues of the carrier to offset the rate of return which the carrier was being permitted to earn upon the plant while it was being constructed. Not including the credit to revenues of IDC for ratemaking purposes would have resulted in the following consequences: (1) the carrier would be permitted to earn a rate of return on plant under construction; (2) the carrier would then be permitted to take the portion of return which was associated with the construction of the plant (IDC) and place that money in the rate base (thereby being compensated twice for the use of the money necessary for construction of the same plant); and (3) the carrier would subsequently be permitted to earn the allowed rate of return upon the IDC, for which the carrier had already been compensated when the carrier had been permitted to earn a rate of return on the plant while it was under construction (see (1), above).

5. A numerical illustration of these concepts may be helpful. Assume that a carrier's allowed rate of return is ten percent, that the carrier borrows at ten percent to finance construction, and that $10,000 in construction expenditures occur during 1978. Under this scenario, the carrier is permitted to recover its cost of capital (the allowed rate of return of ten percent) on the construction, or $1,000 ($10,000 x .1) during 1978. The subsequent inclusion of IDC (10,000 x .1=$1,000) during 1978 in the carrier's rate base would permit the carrier to recover a second round of capital costs (the "double

count") when that carrier is subsequently permitted to recover the $1,000 of IDC in increased depreciation expense in subsequent time periods, and is also permitted to earn the allowed rate of return upon the IDC that is in the rate base. The offsetting entry that we had required from Docket No. 16258, 9 FCC 2d 960, 972 (1967), *reduced* the revenue requirement *by adding*, for *rate evaluation purposes*, IDC to the revenues that the carrier was receiving. This had the direct effect of increasing the measurement of the carrier's earnings for *ratemaking* purposes.

6. The treatment of IDC that was discussed in the three preceding paragraphs was examined by the Trial Staff in Docket No. 19129. In our *Phase II Final Decision and Order in Docket No. 19129, supra* at 60, we found "sufficient merit in the Trial Staff's criticism of our present procedures for treating PUC and IDC to institute changes to eliminate some of the problems it has asserted." Specifically, our Order stated:

> [w]e shall continue the practice . . . of including short-term construction projects in the current rate base as the investment is incurred. We shall, however, neither compute nor capitalize IDC on such amounts, but rather . . . treat short-term projects similarly to plant in service.
>
> * * * *
>
> Furthermore, we shall require all projects which actually take longer than one year to complete to be removed from the rate base at the end of the year, unless given a waiver by this Commission. In that event, IDC will be computed starting at the end of one year in accordance with the procedures set forth below. Additionally, any project suspended longer than six months will be removed from the rate base and no IDC will be computed on such amounts. Projects designed with construction time exceeding one year will be removed from the rate base *ab initio* . . . .

64 FCC 2d 1, 59 (1977). In addition, we explained that:

> [w]e realize that changes to the Uniform System of Accounts will be required in order to implement these rate base changes, as projects with completion dates exceeding one year must be isolated from those taking less than one year. We are also concerned that the necessary accounting changes are not inconsistent with regulatory systems of the several states. Accordingly, we are by separate Order instituting a proceeding, pursuant to Section 220(i) of the Act . . ., to solicit the views of the states on the proposed accounting changes.

Id. at 60.

7. The proceeding to amend the Uniform System of Accounts ("USOA") as suggested in Docket No. 19129 was instituted by a Notice of Proposed Rulemaking, which was adopted on April 28, 1977 (Docket No. 21230), and published in the *Federal Register* on May 13, 1977, 42 *Fed. Reg.* 24291). In that Notice, we pointed out that in our *Phase II Final Decision and Order* in *Docket No. 19129* we had "prescribed, among other things, the treatment of certain plant and expense items for ratemaking purposes"; that "[a]lthough the investigation in Docket No. 19129 was limited to the operations of [AT&T] . . . the conclusion reached therein should be rules of general applicability"; and, that the USOA "should therefore reflect the rate base prescriptions." Our Notice of Proposed Rulemaking repeated the view expressed in Docket No. 19129 that "orderly implementation of certain of those prescriptions [including plant under construction] will require amendment of the Uniform System."

8. On February 24, 1978, subsequent to the institution of the rulemaking proceeding to modify the necessary accounts, we considered on our own motion (FCC 78-103,

67 FCC 2d 1429) the problem of plant under construction and IDC in Docket No. 19129 and observed that:

> [u]nder the provisions of our decision [Docket 19129], see para. 322, our revised treatment of Plant Under Construction (PUC) and Interest During Construction (IDC) for ratemaking purposes became effective for reporting year 1977. It was also originally determined that certain changes to our accounting rules were necessary for the orderly implementation of our revised policy. Accordingly, on May 9, 1977, we released a Notice of Rulemaking for comment by various states regarding the proposed amendments to the Uniform System of Accounts . . . . Until that time [*i.e.*, until the USOA is amended in accordance with the requirements of Section 220 of the Act], *present accounting rules will remain in effect, although, for ratemaking purposes,* interest is not to be calculated on projects scheduled to be completed in less than one year.

67 FCC 2d 1429, 1435-36 (emphasis added).

We further stated:

> [*w*]*e are using this opportunity to clarify the rate base treatment of IDC accrued before the effective date of the above accounting change. For the reason stated below, we find the appropriate treatment is to disallow such IDC for ratemaking purposes* during calendar year 1977. Traditionally, IDC has been designed, in part, to compensate investors for funds prudently invested in construction projects, since projects while under construction generally generate neither revenues nor profits. However, because we are allowing investment in construction projects that are completed in less than one year to be included immediately in the rate base, AT&T will have the opportunity to earn an immediate fair return. *To allow AT&T the additional opportunity to capitalize*

> *IDC at the time the associated PUC goes into service, and thus to recover such IDC over the life of the facility, would compensate AT&T's investors twice. We find such "double counting" not to be in the public interest and shall therefore disallow such IDC, effective January 1, 1977, from respondent's interstate rate base.*

Id. at 1436 (emphasis added).

9. About a month later, on March 27, 1978, Mr. William R. Stump, AT&T Assistant Vice President for FCC Financial and Accounting Matters, wrote to the Chief of the Common Carrier Bureau seeking additional information as to the treatment of IDC. The letter stated:

> [i]t is clear that the Commission intends to disallow the inclusion of IDC from the rate base, for ratemaking purposes, during the pendency of changes in the Uniform System of Accounts to avoid any possibility of "double dipping" during the Docket 19129 (Phase II) Final Order and the necessary accounting changes in Docket 21230.
>
> It also appears to be the Commission's intent in Paragraphs 14 and 15 to restore this IDC to the rate base once the new accounting changes go into effect and the opportunity for "double dipping" no longer exists.
>
> While this is a logical approach and appears to be the intent of the Commission, the wording in Paragraphs 14 and 15 is not as clear as it might be in this regard. It would be helpful if this point could be clarified in the Order prescribing the necessary accounting changes.

In reply, the Bureau Chief agreed with AT&T's interpretation that the Commission's intent in Docket No. 19129 was to exclude IDC from the rate base for rate-

making purposes pending necessary accounting changes as a means of avoiding the opportunity for "double dipping." On the other hand, unlike AT&T, the Bureau Chief did "not read the Commission's order as evidencing an intent to restore the IDC to rate base once the new accounting changes prescribed by Docket 21230 become effective."

10. On May 11, 1978, the Commission issued the *Amendment of Part 31 Report and Order* (Docket No. 21230), 68 FCC 2d 902. Consistent with our findings in Docket No. 19129, our decision in Docket No. 21230 amended the USOA to require, *inter alia*, that the *account* for telephone plant under construction be subdivided into two parts: one to show those projects to be completed within one year (short-term projects); the other to show those projects to be completed in more than a year (long-term projects). Basically, those projects to be completed within one year were to be placed in the plant accounts immediately and no IDC was to be accrued thereon. Long term projects (*e.g.* those which are to be completed in more than one year) were to accrue IDC but were to be placed in plant accounts only when ready for service. Those *accounting* changes were ordered to become effective on January 1, 1979. See *Amendment of Part 31, supra*, at 908; *recon.*, FCC 79-678 (released November 6, 1979).

11. On June 2, 1978, AT&T filed an "Application for Review" challenging the conclusions reached by the Bureau Chief in his May 8, 1978, letter "as contrary to statutory requirements, case precedent, the Commission's decision in Docket 19129 Phase II and Commission policy." AT&T requested that we set aside the Bureau Chief's conclusions and hold instead:

1. that IDC accrued by AT&T on short term Plant Under Construction in 1977 and 1978 was allowable for interstate ratemaking purposes; and

2. that the Bureau Chief exceeded his authority in concluding that interest accrued on short term plant during 1977 and 1978 should be written off AT&T's books as an unrecoverable cost.

AT&T's Application For Review also stated:

> [w]hile it is true, as [the Common Carrier Bureau Chief's] letter states, that "capitalized IDC is recovered through increased depreciation charges over the life of the plant on which IDC was initially accrued" *this does not amount to double counting, so long as the IDC is included as income for ratemaking purposes* . . . (emphasis added)

12. Thus, AT&T's June 2, 1978, Application For Review requested, for ratemaking purposes during 1977 and 1978, that this Commission continue in effect the IDC treatment that AT&T was then using for accounting and ratemaking purposes in its IMR 1 reports which was, in fact, the same accounting and ratemaking treatment that this Commission had prescribed in 1967 in Docket No. 16258. *As noted above, AT&T expressly stated that IDC, under that method, must be included with income for ratemaking purposes to offset the "double counting" that would otherwise result.* Upon further consideration, we granted AT&T's request that had the consequence that insofar as the ratemaking treatment of IDC on Plant Under Construction was concerned for 1977 and 1978, *AT&T would continue its existing reporting of IDC* (which included the revenue credit of IDC to offset "double counting") and that our ratemaking assessment would correspond thereto.[5]

13. Against this factual backdrop, we now consider AT&T's statements regarding the appropriate treatment

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[5] *See In the Matter of the American Telephone and Telegraph Co.*, 72 FCC 2d 1 (decided December 21, 1978; adopted in final form on May 30, 1979; released June 1, 1979).

of IDC during 1978 insofar as they concern the measurement of AT&T's earned rate of return for 1978. On January 19, 1979, AT&T stated, with respect to AT&T's earned rate of return during 1978: "[i]n 1978, on the basis of full compliance with Docket 19129 (Phase II) requirements it was 10.02%—for all practical purposes, right at the upper part of the range. . . ." (Letter from Mr. William Stump, AT&T, to the Acting Chief of the Common Carrier Bureau, dated January 19, 1979).

14. On May 3, 1979, in response to a letter by the Chief of the Common Carrier Bureau with respect to the 10.02% measurement, AT&T stated:

> [y]ou ask that we fully explain the difference between the 10.22% rate of return reported on the Interstate Monthly Report No. 1 (IMR 1) and the 10.02% rate of return mentioned in my letter as having been calculated on the basis of full compliance with the Docket 19129 (Phase II) requirements.
>
> The 20 basis point difference between the 10.22% reported on the December 1978 IMR 1 as the 1978 interstate ratio of net earnings to average net investment and the 10.02% ratio mentioned in my letter to you as the 1978 ratio on the basis of full compliance with the Docket No. 19129 requirements *results from the adjusting out of amounts of interest during construction accrued on short-term plant under construction in 1978* (see Attachment). The 1977 and 1978 operating results reported in the 1978 IMR 1's reflected the Docket No. 19129 decision except for the accrual of these amounts of interest during construction because the changes to Part 31 of the Commission's rules which would result in full implementation of this Decision in this regard were not effective until January 1, 1979. (Letter from Mr. William R. Stump, AT&T, to the

Chief, Common Carrier Bureau, dated May 3, 1979.) (emphasis added)

15. In response to further inquiry as to the measurement of AT&T's earned rate of return during 1978, Mr. Stump stated, in a letter to the Chief of the Common Carrier Bureau that was dated July 25, 1979: "[t]he rate of return of 10.22% shown on the December 1978 Interstate Monthly Report No. 1 is the rate of return for 1978 based on the Commission's directives appropriate to that year, including the December 21 decision mentioned above."

16. In its comments in this proceeding, AT&T has stated: "[t]he 10.02 and 9.89 percent measurement differ from the 10.22 and 10.1 percent measurements, respectively, only in that the former two measurements, but not the latter two, reflect full implementation of the Commission's Phase II decision in Docket 19129." (AT&T comments, para. 63.) AT&T further stated, in a footnote to paragraph 64 of its comments that: "[t]he 10.1 per cent was a rounding of a 10.09 percent, so that the excess is only 9 basis points."

17. Thus, AT&T has stated in its letter of May 3, 1979, and in its comments in this proceeding that the difference between 10.02% and the 10.22% reported in AT&T's December, 1978, IMR 1 results from AT&T's "adjusting out" IDC for 1978. Similarly, the 9.89% measurement supplied in AT&T's comments (paras. 60, 63, 64) results from AT&T's "adjusting out" IDC for 1978 from the 10.09% earned rate of return that AT&T reported in its "1978 Annual FDC Report." As heretofore noted, those proposed downward IDC adjustments and the earned rates of return measurements associated therewith have been rejected. As we have therefore stated *for ratemaking as well as for accounting purposes during 1978, IDC must be added to AT&T's revenues for interstate and foreign services to prevent double count-*

ing. In its June 2, 1978, Application For Review, AT&T acknowledged that IDC must be added to income to prevent double counting during 1978 (see para. 11, *supra*), and our June 1, 1979, Memorandum Opinion and Order expressly recognized that fact. *See Memorandum Opinion and Order In The Matter Of The American Telephone and Telegraph Company*, 72 FCC 2d 1, 6 (1979). The "full implementation of the Commission's Phase II decision in Docket 19129" to which AT&T refers (AT&T comments, para. 63; AT&T letters of January 19, 1979, and May 3, 1979) not only involved accounting changes that were effective on January 1, 1979, *but also involved concommitant ratemaking changes to prevent double counting that were also not effective until January 1, 1979.* AT&T's proffered "full implementation" of our Phase II Decision in Docket No. 19129, by now including for 1978 inapplicable January 1, 1979, accounting changes (which intentionally were not to become effective until January 1, 1979), would, for 1978, result in the exact result that we have consistently sought to avoid: a double reocvery of IDC.

APPENDIX B

1. This Appendix contains a brief history of AT&T filings and FCC proceedings that relate to tariffs under which AT&T was providing interstate services during 1978.

2. On January 29, 1976, AT&T filed "Transmittal No. 12497" which contained revisions to Tariffs FCC Nos. 259, 260, 263, 264, and 267, which were represented as having been designed to yield a 9.5% rate of return. On February 5, 1976, after a full hearing, the Commission released a Memorandum Opinion and Order in Docket No. 20376, 57 FCC 2d 960 (1976), which prescribed a fair rate of return for AT&T of 9.5% and permitted AT&T to earn an additional 0.5% as "an incentive to increased productivity and efficiency." *Id.* at 973. On March 1, 1976, we released a Memorandum Opinion and Order in Docket No. 20732, 58 FCC 2d 1 (1976), which considered the tariff revisions that were contained in Transmittal No. 12497. As noted therein, numerous issues were raised by participants in that proceeding that were also, in part, being considered in Docket Nos. 18128, 19989, and 20288. Accordingly, pursuant to Sections 4(i), 4(j), 204, 205, and 403 of Communications Act of 1934, as amended, the tariff revisions that were contained in Transmittal No. 12497 were suspended for one day, a hearing was instituted into the lawfulness of those tariff revisions, the hearing was held in abeyance pending further order of this Commission, and we required "that AT&T maintain an accounting of the revenues derived under these revised tariffs, for possible refund upon resolution of the lawfulness thereof." *Id.* at 5. On March 26, 1976, we released an "Errata" in Docket No. 20732, FCC 76-248, 58 FCC 2d 905 (1976), which, *inter alia*, revised paragraph 14 of our Memorandum Opinion and Order in Docket No. 20732, *supra*, at 5, to read:

> [f]or the reasons indicated we shall order AT&T and all participating telephone companies to maintain accounts by service classes and subclasses, in the aggregate, specifying the amounts of all increases and the service classification for which such amounts are accounted. Classifications for which accounts must be kept are as follows: (1) private line services, by series; (2) MTS and WATS, insofar as rates have been increased, and for each classification of service (e.g., dial station, operator-assisted, inward WATS, outward WATS, etc.); (3) DDS; and (4) all other services.

58 FCC 2d 1, 5 (1976). Service of the Errata upon AT&T was effected on March 26, 1976. On March 29, 1976, the Commission released a Memorandum Opinion and Order in Docket No. 20736 (In the Matter of American Telephone and Telegraph Company Revision to Tariff FCC No. 260 (Series 1000)), 58 FCC 2d 899 (1976), which similarly provided for the suspension of certain AT&T tariff revisions, the institution of a hearing at a date to be specified, and the imposition of an accounting order upon AT&T and upon all carriers participating in the provision of the Series 1000 service. *Id.* at 903. In our Final Decision and Order in Docket No. 19989, 59 FCC 2d 671, 709-10 (1976), after having found the WATS tariff filings at issue therein to be unlawful, we stated

> [a]lthough the WATS tariff has been found unlawful as indicated herein, there is a clear public interest requirement for continuity of Inward and Outward WATS service to the public. Further, this procedure will avoid the confusion and administrative difficulties which would likely arise if an alternative WATS tariff was filed to become effective during the interim period while Bell prepared the tariff filing required by our Decision. Finally, we note that existing accounting orders shall continue as set forth herein to protect the public and we re-

tain our rights to investigate or reject or impose an accounting order with respect to the tariff revisions which Bell must file. In view of the foregoing, the course outlined above will best serve the public interest.

Our Designation Order herein imposed an accounting order by individual customer account on Bell for all charges which were increased under the filing of Transmittal No. 11935, 46 FCC 2d at 86. No accounting order was imposed for the increased charges resulting from Bell's March 1975 filing under Transmittal No. 12303, 52 FCC 2d 155, 156, and a 'class' accounting order was imposed for the increased charges resulting from Bell's February 1976 filing under Transmittal No. 12493, Docket No. 20732, 58 FCC 2d 1, 4-5 (1976). Moreover, an accounting order by individual customer account remains outstanding with respect to the 1973 WATS rate increases, 40 FCC 2d 18, 20. As indicated above, we have found the foregoing WATS tariff filing unlawful. In the normal case where charges are found unlawful after hearing, we would prescribe lawful rates, and therefore know what portions of the increases are lawful. Here, however, we have an insufficient record to support a rate prescription, and we therefore believe it an appropriate exercise of our discretion not to order any refunds pending consideration of the tariff revisions filed in accordance with this Decision.

Accordingly, we will leave the accounting orders now pending in effect. However, to the extent possible, we shall order Bell to convert the existing accounting orders by individual account into "class" accounting orders, i.e., for Outward MT, Outward FBD(FT), Inward FBD(FT) services, upon the effective date of this decision. . . .

* * * *

> IT IS FURTHER ORDERED, that the accounting orders pursuant to 40 FCC 2d 18, 20 and 46 FCC 2d 81, 86 SHALL BE CONVERTED to class accounting orders (for Outward MT, Outward FT/FBD, Inward MT, Inward FT/FBD categories of service) insofar as feasible.

Id. at 709-10. By subsequent Memorandum Opinion and Order in Docket No. 19989, 64 FCC 2d 538, 540-41 (1977), which was released on April 18, 1977, we clarified the earlier accounting orders in Docket No. 19989, *supra*, at 709-10, by stating:

> [i]n its Reply to AT&T's Opposition, National Data restates its view that existing individual accounts should not be destroyed nor converted to class accounts if the effect would be to eliminate the basis for possible individual customer refunds, for WATS customers who have relied upon the accounting order by individual account issued by the Commission for the period March 14, 1973 to March 8, 1975 as the ultimate source of relief. National Data points out that with respect to future individual account record keeping it has not sought to require compilation of such records. It also does not deny that it is "concerned about its own hopes for a refund," claiming it has suffered several dramatic increases in its WATS charges since 1973, much to the detriment of its business operations and economic well being. National Data further renews its request that the Commission provide AT&T's WATS customers some indication as to its view of the likelihood that individual refunds, for the years 1973, 1974 and 1975, will be ordered so that if necessary, such customers may consider seeking alternate relief. Finally, National Data claims its participation in the informal discussions between AT&T and the Bureau will be of assistance due to its thorough knowledge of the issues which it obtained as a party to Docket No. 19989.

> To the extent indicated below, we grant the relief requested by National Data. In regard to National Data's concern about accounting orders and records, our March 1, 1976 action in Docket No. 20732, *supra*, sets forth the public policy reasons justifying the entry of class accounting orders and supports the conversion of accounting orders by individual customer account to class accounting orders as ordered in this particular case. In our March 1, 1976 action, 58 FCC 2d at 4, we stated that "[i]n major rate cases . . . , the imposition of individual accounting requirements [is] a costly, inefficient, and largely ineffective means of protecting the public interest." Although we ordered the conversion to class accounting, and reaffirm that decision here, we never expected AT&T to physically convert the two accounting orders until we first decided whether or how any alleged refund liability was to be considered or determined. See 59 FCC 2d at 709. Thus, no destruction of existing individual account records, which is National Data's major concern, has occurred or will occur in the future pending further Commission order.

64 FCC 2d 538, 540-41. In the Phase II Final Decision and Order in Docket No. 19129, 64 FCC 2d 100-01, 110, released on March 1, 1977, we terminated the outstanding accounting orders with respect to AT&T's Message Telecommunications Service. On May 9, 1977, this Commission issued a clarifying Memorandum Opinion and Order, FCC 77-310, which, *inter alia*, stated:

> [O]n March 1, 1977, we released the Phase II Final Decision and Order in our Docket No. 19129 investigation of AT&T, FCC 77-150, —— FCC 2d ——. We found in that proceeding, *inter alia*, that the rate level of AT&T's Message Telecommunications Service (MTS), reflected in the earnings ratio from the service through 1975, was just and reasonable

during the period of this proceeding. Para. 253. Accordingly, we concluded that maintenance of the outstanding accounting orders, with the costs thereof placed upon the operating expenses of AT&T, was no longer required and terminated all such accounting orders with respect to MTS. Paras. 276, 328.

In the Phase II Final Decision, *supra*, we found the overall rate levels of MTS reasonable through 1975, but we have taken no position on the lawfulness of the 1976 rate increase. As long as the question of the reasonableness of the MTS rate level in that filing remains under question (footnote omitted), we believe it inappropriate to terminate the MTS 1976 accounting order. Therefore, we hereby clarify that para. 328 of the Phase II Final Decision, *supra*, does not terminate the accounting order in this proceeding [Docket No. 20732].

Accordingly, IT WAS ORDERED, That the accounts ordered in this proceeding at 58 FCC 2d 1, 5 (1976) shall continue to be kept until further order of this Commission.

3. On May 9, 1977, the preceding Memorandum Opinion and Order in Docket No. 20732 was served upon AT&T. Pursuant to Section 408 of the Communications Act of 1934, as amended, 47 USC § 408, that order remained in full force and effect during 1978.

4. By Memorandum Opinion and Order in Docket No. 18128, 61 FCC 2d 587, 669 (released October 1, 1976), this Commission terminated all extant accounting orders in Docket No. 18128. However, upon reconsideration, by Memorandum Opinion and Order released on June 13, 1977, 64 FCC 2d 971, 993, we reinstituted the accounting orders in Docket No. 18128. Upon further reconsideration, Second Order on Reconsideration in Docket No. 18128, 67 FCC 2d 1441, 1453 (released February 24,

1978), we reaffirmed the reinstitution of the extant accounting orders in Docket No. 18128, and stated:

> [a]s noted above, certain rate increases were found unjustified while others like Telpak are still subject to further proceedings. This circumstance allows that certain users may have been overcharged and may be entitled to refunds either presently or at the outcome of the proceeding. Clearly, the carrier, which has the burden of justifying its rates, should carry the risk of failure in the proceeding, not the customer. AT&T would have us place the customer in the position of bearing the entire risk of overpayment in the event that rates are proven unlawfully high. We must reject the view, and therefore hold that maintenance of the accounting orders is necessary to continue to protect customer interests still extant in this proceeding.

Id. at 1453.

5. During 1978, AT&T had in effect several tariffed rates that the Commission has found to be unlawful or that have been continued pursuant to Court order. During April, 1976, AT&T filed Tariff revisions 12546 and 12547 introducing the multi-schedule private line (MPL) rates. On May 19, 1976, the Commission suspended the effective date of the MPL rates, and set those rates for investigation. In the Matter of American Telephone & Telegraph Company, 59 FCC 2d 428 (1976). At that time, we stated:

> [s]ubstantial questions have been raised concerning the lawfulness of the MPL rate structure. Some of the specific features of the tariff which need close scrutiny are, among others, the increases in the charges of services of 25 miles or less in length, the high charge for the first mile of service, the possible anti-competitive implications of the decreases in

> charges for long haul services, and the possibility of unlawful discrimination between users.

Id. at 431. The MPL rates became effective on August 20, 1976, following expiration of the three-month suspension period. Those rates remained in effect with minor revisions through 1978. On March 19, 1979, the Administrative Law Judge, after a lengthy hearing, released his decision. As reported in the Commission's final decision, the Administrative Law Judge:

> found eight separate violations of Docket No. 18128 requirements in the MPL cost studies. He thus concluded, that the costing practices and classifications underlying those cost studies are not just and reasonable within the meaning of Section 201(b) of the Communications Act (47 USC § 202(b)); that AT&T has failed to demonstrate that such classifications and practices would not constitute an unjust or unreasonable discrimination in violation of Section 202(a) of the Act. (47 USC § 202(a)); and that AT&T has not met or even attempted to meet the cost allocation guidelines set out in the Docket No. 18128 Decision. The Judge concluded that the Series 2000/3000 transmittals at issue are unlawful and must be rejected.

In the Matter of American Telephone and Telegraph Company, 74 FCC 2d 1, 7 (1979). On September 20, 1979, the Commission in its Final Decision in Docket No. 20814 found that as a consequence of the use of AT&T's basic service philosophy, AT&T had "failed to carry its burden of justifying the MPL tariff under Section 201(b) of the Act in accordance with Docket No. 18128 requirements." 74 FCC 2d 1, 41 (1979). The Commission then concluded that the public interest required that AT&T's tariff remain in effect until the Commission was in a position to prescribe new rates, or until a new carrier initiated tariff became effective. In the

Commission's Final Decision and Order in Docket No. 19989, 59 FCC 2d 671 (1976), *recon.*, 64 FCC 2d 538 (1977), the Commission, in considering AT&T's WATS tariff rates, concluded that:

> pursuant to Section 201(b) and 202(a) of the Act, the tariff schedules filed with Bell Transmittal Nos. 11657 and 11935 (and revisions thereto) are found unlawful as indicated herein, ARE NULL AND VOID, effective 210 days after publication of this Decision in the Federal Register.
>
> IT IS FURTHER ORDERED, That Bell shall file tariff revisions accompanied by the information required by Section 61.38 of the Commission's Rules, 37 CFR 61.38, and which meet the guidelines specified herein;
>
> * * * *
>
> IT IS FURTHER ORDERED, That the provisions of Section 61.58 of the Commission's Rules, 47 CFR 61.58, ARE WAIVED, and the tariff revisions to be filed on not less than 60 days notice; 59 FCC 2d 671, 709-710.

In response to this order, AT&T filed Transmittal 12745 which was to become effective on August 1, 1977. On July 21, 1977, the Commission concluded that

> AT&T's WATS tariff filing, Transmittal No. 12745, IS REJECTED, except to the extent WATS services are to be initiated to and from points outside the 48 contiguous states. . . .
>
> IT IS FURTHER ORDERED, That the effective date of paragraph 90 of our Decision in Docket No. 19989, 59 FCC 2d 671, 709-710 (1976), which declared the present WATS tariff null and void IS DEFERRED, pending further Commission Order.

In the Matter of American Telephone and Telepgraph Company (Long Lines Department) Revisions to Tariff

FCC No. 259 Wide Area Telecommunications Service (WATS), Transmittal No. 12745, 66 FCC 2d, 62-63 (1977).

6. On November 21, 1978, the Commission, in the preceding WATS Decision, set forth a mechanism for the filing of revised WATS tariffs. Thus, the WATS tariffed rates, found to be unlawful in 1976, remained in effect during 1978 with the minor exceptions noted above. On January 17, 1977, the Commission released the Memorandum Opinion and Order In The Matter of American Telephone and Telegraph Company Investigation Into The Lawfulness Of Tariff FCC No. 267, Offering A Dataphone Digital Service Between 5 Cities (Docket No. 20288), 62 FCC 2d 774 (1977), *recon. denied*, 64 FCC 2d 994 (1977), regarding the provision of dataphone digital service. In that Decision, the Commission stated:

> [T]he rates and conditions of AT&T's Tariff No. 267, as specified herein, are unjust, unreasonable, and unlawful, in violation of § 201(b) of the Communications Act. . . . Accordingly, we require AT&T to file an interim tariff offering dataphone digital service at rates designed to yield the 9.5% return, as provided herein, no later than February 22, 1977, effective on thirty days notice.

62 FCC 2d FCC 2d 774, 807 (1977). AT&T filed interim rates patterned after the rates in Tariff No. 260 (Series 2000/3000) under Transmittal 12687 which became effective on March 24, 1977. In allowing those tariffed rates to become effective, the Commission stated:

> [we] find that AT&T has substantially complied with our guidelines set forth in the Docket 20288 Decision. Upon examination of the arguments in the petitions for investigation and rejection, we cannot agree that the requested relief is warranted. Therefore, we will allow the tariff revisions which reflect the interim rates to become effective.

In The Matter Of American Telephone and Telegraph Company, 63 FCC 2d 936, 937 (1977). On July 25, 1977, AT&T filed revised Dataphone Digital Service ("DDS") tariffs under Transmittal 12790 to become effective on January 16, 1978. On January 12, 1978, the Commission rejected proposed DDS tariff rates on the ground that the filing did not comply with the Commission's Order in Docket No. 20288. In The Matter Of American Telephone and Telegraph Company Revisions Of Tariff No. 267 Dataphone Digital Service (DDS), 67 FCC 2d 1195 (1978), *recon. denied*, 70 FCC 2d 616 (1979). Since its initial tariff offering service to five cities, AT&T expanded in phases the number of cities to be served. Each incremental tariff filing for each incremental service was based upon the interim rates that were filed in 1977.

7. On October 1, 1976, the Commission released its Memorandum Opinion and Order in Docket No. 18128, 61 FCC 2d 1444 (1978), *aff'd. sub nom.* Aeronautical Radio, Inc. v. FCC, 642 F.2d 1221 (D.C. Cir., 1980), *cert. denied.* 451 U.S. 920 (1981). In that Decision, the Commission found that it was:

> [u]nable to find that the TELPAK offering, as presently structured, constitutes a proper response to the extent of competition posed by private microwave. We nevertheless believe that a properly structured bulk rate offering, which would compete with private microwave or other competitive alternatives is justified. However, it is clear from the record herein, that the *nationwide* rate differential existing between TELPAK and like private line service cannot be supported by alleged cost comparability between TELPAK and hypothetical private microwave systems.

61 FCC 2d 587, 658 (1976) (emphasis in the original). In response to this finding, the Commission concluded that:

> The rate level differential existing between TELPAK and other private line services constitutes an unlawful discrimination between like services under Section 202(a). We do recognize, however, the benefit to industrial, transportation and government users from a bulk offering. Bell may file within the eight month period outlined below a new appropriately responsive bulk offering consistent with our guidelines herein, which can be supported on the basis of competitive necessity, costs, or other relevant factors.

Id. at 659. In response to this directive, AT&T filed tariff changes to eliminate the Transmittal No. 12714 TELPAK (Series 5000) offering. On reconsideration of the Final Decision in Docket No. 18128, the Commission decided that:

> [c]onfusion on the [scope of the Notice of questions at issue] may have resulted from differing statements contained in orders issued during this somewhat convoluted and protracted proceeding. We shall on this ground reconsider the matter of TELPAK's lawfulness as well as whether the return levels on these discounted rates fall within the zone of reasonableness.
>
> * * * *
>
> Consequently, we set aside, and accordingly stay our Order requiring Bell to eliminate TELPAK by June 8, 1977 . . . and will conduct an expedited hearing on the question of TELPAK's lawfulness in general under Sections 201(b) and 202(a) of the Act.

64 FCC 2d 971, 985 (1977).

In addition, the Commission stated:

> [i]n conclusion, on reconsideration we find that the TELPAK discounts, now subject to termination at the carrier's option, have not yet been justified on

> the basis of either a cost differential, an overall return level, or competitive necessity. Such justification will be the subject of the further hearings we are ordering herein.

Id. at 989. On June 2, 1977, the Commission issued an Order denying petitions to suspend or reject AT&T's tariff filing terminating the TELPAK offering. In The Matter of American Telephone And Telegraph Company Long Lines Department Revisions To FCC Tariffs No. 258 and 260 (series 5000) Termination of TELPAK Service, 64 FCC 2d 959, 968 (1977). On July 21, 1977, the United States Court of Appeals for the District of Columbia Circuit enjoined AT&T from discontinuing the TELPAK offering to existing customers pending review of the Commission's Order allowing the terminating tariff to take effect. Those TELPAK rates remained in effect through the period under consideration here.

8. Thus, the Commission had not only found specific AT&T tariffs that were in effect during 1978 to have been unlawful, but the Commission had also imposed accounting orders with respect to interstate services that were being provided by AT&T. To the extent that services with associated charges that have been found to be unlawful have been provided though common plant with other services at charges that have not been found to be "just and reasonable", we confront a situation that, in the absence of an upper bound to the carriers earnings, would potentially permit unlimited rates of return on regulated services. We do not believe that Congress intended such a result. Nor do we believe that such a consequence would be consistent with Section 1 of the Communications Act of 1934 or the obligations that are imposed under Sections 201-205 of the Communications Act.

APPENDIX D

FCC 85-284
35867

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

CC Docket No. 79-187

IN THE MATTER OF

AT&T EARNINGS ON INTERSTATE AND FOREIGN SERVICES DURING 1978

MEMORANDUM OPINION AND ORDER

Adopted: May 29, 1985 Released: May 30, 1985

By the Commission:

1. On December 11, 1984, we issued a *Restitution Decision*[1] in CC Docket No. 79-187 that: (1) concluded that AT&T and the Bell Operating Companies "BOCs" had received $101,000,000 in excess interstate revenues during 1978;[2] (2) imposed a restitution obligation consisting of $101,000,000 plus accrued interest (hereinafter, "restitution obligation");[3] (3) tentatively divided that restitution obligation in a manner analogous to the appor-

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[1] *In the Matter of AT&T Earnings on Interstate and Foreign Services During 1978* (CC Docket No. 78-187), FCC 84-567 (December 11, 1984) [*"Restitution Decision"*], 49 Fed. Reg. 49502 (December 20, 1984).

[2] *Id.* at para. 15.

[3] *Id.* at paras. 16-19.

tionment of contingent liabilities in the Bell System Plan of Reorganization approved by the U.S. District Court as part of the antitrust settlement in *United States v. AT&T*;[4] and (4) provided that restitution would be effected through reductions in revenue requirements that were to be reflected in tariffs for interstate services that would be filed during the spring of 1985.[5] Eight petitions for reconsideration have been filed that collectively seek a re-examination of many of the major conclusions that were contained in our *Restitution Decision.*[6] In this

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[4] *Id.* at para. 19, n.28.

[5] *Id.* at para. 19.

[6] *Petition for Reconsideration* filed by the American Telephone and Telegraph Company on January 22, 1985 (*"AT&T Petition"*); *AT&T's Response to Petitions for Reconsideration* filed on March 1, 1985 (*"AT&T Response"*); *Petition for Reconsideration* filed by the Bell Atlantic Telephone Companies (Bell Telephone of Pennsylvania, the Chesapeake and Potomac Telephone Companies, the Diamond State Telephone Company, and the New Jersey Bell Telephone Company) on January 22, 1985 (*"Bell Atlantic Petition"*); *Request for Clarification and Contingent Petition for Reconsideration* in CC Docket Nos. 78-72 and 80-286 filed by the GTE Service Corporation and the GTE domestic operating companies (General Telephone Company of California, General Telephone of Florida, General Telephone Company of Kentucky, General Telephone Company of the Southeast, Hawaiian Telephone Company, Bethel and Mt. Aetna Telephone & Telegraph Company, General Telephone Company of Illinois, General Telephone Company of Indiana, Inc., General Telephone Company of Michigan, General Telephone Company of the Midwest, General Telephone Company of Ohio, General Telephone Company of Pennsylvania, General Telephone Company of Wisconsin, General Telephone Company of Alaska, General Telephone Company of the Northwest, Inc., West Coast Telephone Company of California, and GTE Satellite Corporation) (collectively, "GTE") on January 22, 1985 (*"GTE Request for Clarification"*); *Petition for Reconsideration* filed by Nevada Bell Telephone, New England Telephone and Telegraph Company, New York Telephone Company, Pacific Bell Telephone Company, South Central Bell Telephone Company, Southern Bell Telephone and Telegraph Company, Southwestern Bell Telephone Company (collectively termed "BCR Attachment A Companies") on January 22, 1985 (*"BCR Petition"*); *Petition for*

Reconsideration Order we: (1) reaffirm those portions of our *Restitution Decision* that apply to AT&T and the BOCs (hereinafter collectively referred to as "AT&T" unless the context indicates otherwise); and (2) modify certain portions of the *Restitution Decision* that apply to non-AT&T companies so as to relieve those companies from any participation in the restitution obligation.

I. BACKGROUND

2. During the summer and fall of 1978, the Common Carrier Bureau conducted an informal investigation of AT&T's interstate earnings.[7] At that time, it appeared

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Reconsideration filed by the Mountain States Telephone and Telegraph Company, Northwestern Bell Telephone Company, and Pacific Northwest Bell Telephone Company (hereinafter, "U.S. West") on January 22, 1985 (*"U.S. West Petition"*); *Petition for Reconsideration of the Rural Telephone Coalition* filed on January 22, 1985 (*"RTC Petition"*); *Petition for Reconsideration* filed by Satellite Business Systems on January 22, 1985 (*"SBS Petition"*); and *Petition for Reconsideration* filed by the United States Telephone Association on January 22, 1985 (*"USTA Petition"*). We also grant herewith the "Motion for Consolidation" filed by The National Telephone Cooperative Association and the Organization for the Protection and Advancement of Small Telephone Companies on May 16, 1985. To the extent stated herein, we also grant: GTE's "Request For Clarification and Contingent Petition For Reconsideration"; incorporate in the record of this proceeding its "CAVEAT"; and rule upon GTE's "Motion for Clarification of Issues and Procedures and For Supplementation of the Record" that was filed out of time, as well as "USTA's Petition For Clarification" that was filed on May 20, 1985.

[7] Authorization for such investigations is contained, *inter alia*, in Sections 0.91 and 0.291 of the Commission's Rules, 47 C.F.R. §§ 0.91 and 0.291 (1978). *See* Sections 4(i)-(j), 5(d), 201-205, 208, and 218 of the Communications Act of 1934, 47 U.S.C. §§ 154(i)-(j), 155(d), 201-205, 208, and 218 (1978). Under prior Commission orders, AT&T was precluded from earning more than a 10.0 percent rate of return. *See AT&T Initial Decision*, 57 FCC 2d 979, 1004-05 (1975); *AT&T Decision* 960, 973 (1976), Sections 205(a) and 408 of the Communications Act of 1934, 47 U.S.C. §§ 205(a), 408 (1978).

that AT&T had exceeded, and most probably would exceed for calendar year 1978, the rate of return limit of 10% that had been ordered in Docket No. 20376.[8] On December 20, 1978, the General Services Administration ("GSA") filed a "Petition for Order to Show Cause" (hereinafter, "GSA Petition") which stated that AT&T's earned rate of return exceeded the allowed rate of return, and requested that this Commission require "AT&T to show cause why the Commission should not instruct AT&T to revise its rates and charges for interstate and foreign services to conform to the levels authorized in Docket 20376 . . . ." [9]

3. After receiving the GSA petition, the Acting Chief of the Common Carrier Bureau formally initiated an investigation into AT&T's interstate earnings during 1978 by requesting, by letter dated December 20, 1978, certain information from AT&T concerning those earnings ("December 20 Bureau Letter").[10] On January 22, 1979, AT&T issued the Interstate Monthly Report No. 1 for December 1978 ("December 1978 IMRl"), that showed that its earned rate of return on the interstate operations for 1978 was 10.22%. Subsequent inquiries and correspondence ensued,[11] and on September 19, 1979, the Commission adopted a Notice of Inquiry that sought comments on the policy issues associated with the enforcement of rate of return prescriptions, data that had been filed by AT&T with respect to the measurement of

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[8] *See AT&T Initial Decision, supra,* at 1004-05; *AT&T Decision, supra,* at 973.

[9] *GSA Petition* at 1-4.

[10] Letter from the Acting Chief, Common Carrier Bureau, to Mr. William R. Stump, Assistant Vice President, AT&T, dated December 20, 1978. *See* para. 2, n.7, *supra,* and Section 412 of the Communications Act, 47 U.S.C. § 412 (1978).

[11] *See generally Restitution Decision* at paras. 2-4 and nn.4-9.

its 1978 interstate earnings, and the mechanism that should be adopted in effecting restitution.[12]

4. After receiving comments on alternative restitution mechanisms, a number of changes occurred in the telecommunications industry affecting the methods that had historically been used to compensate exchange and interexchange carriers for the use of their facilities in interstate services, including the divestiture of the BOCs from AT&T, the development of access charges, and the formation of the National Exchange Carrier Association ("NECA").[13] Although our *Restitution Decision* took those additional factors into account,[14] we nevertheless sought comment on whether the division of the restitution obligation was correct,[15] and whether the implementing tariffs were "just and reasonable" within the meaning

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[12] *Common Carrier—Interstate and Foreign Earnings* (CC Docket No. 79-187), 75 FCC 2d 412, 413-20 (1979) (*"Notice"*).

[13] *See United States v. American Tel. and Tel. Co.*, 552 F.Supp. 131 (1982), *United States v. Western Elec. Co., Inc.*, 569 F. Supp. 1057 (1983); *MTS and WATS Market Structure*, CC Docket No. 78-72, Phase I, 93 FCC 2d 241 (1983) *modified on reconsideration*, FCC 83-536, 48 Fed. Reg. 10319, 54 RR2dd 615 (released on August 22, 1983), *further modified on reconsideration*, FCC 84-36, 49 Fed. Reg. 7810, 55 RR2d 785 (released February 15, 1984) FCC 85-149, —— Fed. Reg. ——, (released April 23, 1985), *aff'd in principal part, Nat'l Ass'n of Regulatory Comm'rs v. FCC* (*"NARUC v. FCC"*), 737 F.2d 1095 (D.C. Cir. 1984), *cert. denied*, 53 U.S.L.W. 3593 (February 19, 1985).

[14] *Restitution Decision* at paras. 17-19.

[15] The *Restitution Decision* apportioned the restitution obligation into an AT&T component and an exchange carrier component, calculated on the basis of the Bell System Plan of Reorganization's contingent liability provisions. *Id.* at paras. 17-19 n.25, paras. 25, 28. *See In the Matter of AT&T's Earnings on Interstate and Foreign Services During 1978* (CC Docket No. 79-187) *Order Denying Requests for Stay*, FCC 85-240 (released May 10, 1985) at para. 4, n.9 and paras. 7-9, (*"Order Denying Requests for Stay"*).

of Section 201(b) of the Communications Act.[16] The petitions for reconsideration that are before us request that we modify the *Restitution Decision* on various factual, legal, and policy grounds.

II. DISCUSSION

A. *Factual Issues*

5. The *Restitution Decision* concluded that the 10.22% interstate earned rate of return measurement that was contained in AT&T's December 1978 IMR 1 would form the basis for calculating the restitution obligations of AT&T and the BOCs.[17] Several petitioners[18] request that we reconsider that portion of our *Restitution Decision*, and, by implication, conclude that a downward adjustment should be made to the 10.22% figure to take into account lower returns on certain interstate services that were purportedly not included in the 10.22% IMR 1 measurement.[19]

6. None of the petitions raise any issues in this regard that were not addressed in the *Restitution Decision*.[20]

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[16] The *Restitution Decision* required prospective reductions in AT&T's interstate rates and exchange carrier rates for access services (through a reduction in the carrier common line rate filed by the National Exchange Carrier Association). *Restitution Decision* at para. 19 n. 28. *See* Section 201(b) of the Communications Act, 47 U.S.C. § 201(b) (1984).

[17] *Restitution Decision* at paras. 11-15.

[18] *AT&T Petition* at 19, 22; *BCR Petition* at 7-8; *Bell Atlantic Petition* at 2; *USTA Petition* at 6-7.

[19] *Id.*

[20] The only quantitative information in this proceeding that purports to measure the interstate revenues, expenses, and rate base allegedly associated with the provision of additional interstate services that were not reflected in the IMR 1 rate of return of 10.22% was provided by AT&T in the form of its "1978 Annual FDC Report." Our discussion accordingly centers upon the probative value

Nevertheless, in the interest of additional clarity, we shall set forth our reasons for rejecting the inconsistent, conflicting measurements of AT&T's 1978 interstate earnings offered by AT&T as alternatives to 10.22%.[21] For this purpose, it will be useful to develop here the chronology and content of the representations that relate to AT&T's 1978's interstate earnings.[22]

7. The December 20 Bureau Letter, *supra*, informed AT&T that, in the Bureau's view, the rate of return prescription was being violated by the Bell System and asked AT&T to provide certain information concerning its interstate earnings.[23] AT&T, by letter dated January 19, 1979, stated that its 1978 interstate earnings were 10.02% ("January 19 AT&T Letter"). On January 22, 1979, AT&T issued its December 1978 IMR 1, that showed a cumulative interstate earned rate of return of 10.22% for the calendar year ending December 31, 1978.[24] On April 20, 1979, the Chief of the Common Carrier Bureau requested that AT&T explain "the numerical discrepancy

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and credibility that were assigned to that report. Of the three remaining measurements (*see Restitution Decision, supra*, at para. 15, n.19), two measurements (*e.g.*, 9.89%, 10.02%) were rejected on the basis of a distorted, and incorrect, application of our Interest During Construction decisions. The remaining measurement (10.22%) formed the basis for the restitution obligation. *See Restitution Decision, supra*, at para. 11, nn.13-14, paras. 12-15, and Appendix A.

[21] *Restitution Decision, supra*, at paras. 3-15, Appendices A & B.

[22] Unless otherwise noted, all statements are based upon correspondence between Mr. William R. Stump, AT&T Assistant Vice-President, and the Acting Chief, or Chief, of the Common Carrier Bureau.

[23] *See AT&T Initial Decision, supra*, at 1004-05 (1975); *AT&T Decision* 960, 973 (1976); and para. 8 n.31, *supra*.

[24] On March 8, 1979, AT&T filed a petition seeking increases in its authorized rate of return. *See generally Restitution Decision* at para. 20 and n.33.

between the 10.22% earned rate of return for 1978 which was contained in the Interstate Monthly Report No. 1 and the earned rate of return of 10.02% for 1978 which was contained in your letter of January 19, 1979." On May 3, 1979, AT&T stated that the discrepancy between the two numbers (*viz.*, 10.02%, 10.22%) could be explained on the basis of Interest During Construction ("IDC") adjustments ("May 30 AT&T Letter"). On June 29, 1979, AT&T filed a "1978 Annual FDC Report", that, *inter alia*, showed an earned interstate rate of return of 10.1%. On July 25, 1979, AT&T confirmed its "position regarding the interstate rate of return for 1978" ("July 25 AT&T Letter"). In relevant part, that letter stated: [25]

> AT&T reports monthly to the Commission the interstate rate of return consistent with the Commission's past decisions as to the appropriate elements of revenues, expenses, taxes and net investment to be used in the calculation of the rate of return. *The report on which the interstate rate of return is shown is the Interstate Monthly Report No. 1.*
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> *The December 1978 Interstate Monthly Report No. 1 showed the interstate rate of return for 1978 to be 10.22%.* This calculation was based on partial compliance with the directives of the Commission in Docket No. 19129 (Phase II) in that certain changes to the elements of revenues and net investment were not to be put into effect until the accounting changes made to Part 31 of the Commission's Rules were effective. As [Mr. Stump] noted in [his] January 19, 1979 response to [the Acting Chief's] December 20, 1978 letter, the going level of the interstate rate of

[25] On July 20, 1979, the National Citizens Committee for Broadcasting, the Consumer Federation of America and the Missouri Public Interest Research Group (collectively, "NCCB") filed a petition that sought to have the Commission determine the extent to which "the legally allowed rate of return" had been exceeded.

> return for 1978 based on full compliance with Docket No. 19129 (Phase II) was 10.02% . . . .
>
> In response to [the question that was raised by the Common Carrier Bureau] *the rate of return of 10.22% shown on the December 1978 Interstate Monthly Report No. 1 is the rate of return for 1978* based on the Commission's directives appropriate to that year, including the December 21 decision mentioned above.[26]

On October 26, 1979, AT&T responded[27] to a further staff request for information, in pertinent part, as follows:

> [P]ursuant to your request, we have computed the revenues that would have been required to achieve an after-tax-rate of return of 10.0% for the year 1978. The data utilized in the attached analysis indicates that the revenues required to achieve a 10.0% return would have been $101.0 million less than the revenues shown on the Interstate Monthly Report No. 1 for the year 1978 as issued by AT&T on January 22, 1979.

Finally, in comments that were filed on November 13, 1979, in response to the *Notice*,[28] AT&T contended, variously, that other measurements (*viz.*, 9.89%, 10.02%, 10.1%) might be more appropriate, depending "upon the purpose of the Commission's review."[29]

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[26] July 25 AT&T Letter (emphasis added).

[27] Letter from Mr. Thomas E. Lawrence, AT&T, to Mr. Glenn deChabert, Common Carrier Bureau, dated October 26, 1979 ("October 26 AT&T Letter").

[28] *Notice, supra* at para. 3 n. 12.

[29] AT&T Comments in CC Docket No. 79-187 at paras. 60-64 (filed November 13, 1979). At para. 64, n.*, after describing the amount of revenues in excess of 10% that would be received under the alternative measurements, AT&T stated that "[t]his figure represents only Bell Revenues and does not include the effect on Inde-

8. USTA contends that our decision to use the 10.22% measurement was "wholly arbitrary." [30] The BCR Attachment A Companies assert that the 10.22% figure "does not represent AT&T's actual earnings." [31] AT&T contends that the rejection of the 10.1% (or 10.09%, or, in its more recent reconsideration petition, 10.0859%) measurement that was contained in AT&T's "1978 Annual FDC Report" is erroneous, and that this Commission should not utilize the 10.22% measurement that AT&T supplied.[32]

9. Basically, in these various arguments, petitioners ask us to reconsider our choice among the conflicting numbers that were provided by AT&T with respect to its 1978 interstate earnings. In the *Restitution Decision*, we considered the five different interstate earned rate of return measurements that AT&T had provided, rejected four of those measurements (10.1%, 10.09%, 10.02%, 9.89%),[33] and concluded that the remaining measurement of record in this proceeding (10.22%) would form the basis for the restitution obligation of those carriers that were bound by AT&T's 1978 tariffs and AT&T's representations with respect to 1978 interstate earnings.[34] At the outset, we note that the four rejected measurements were all based upon "adjustments" to AT&T's December 1978 IMR No. 1 that were provided after AT&T had

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pendent Companies concurring in AT&T's interstate tariffs which presumably would also be included in any refunds ordered by the Commission." In a later section of this Memorandum Opinion and Order, we address those aspects of 1978's interstate operations that pertain uniquely to the Independent telephone companies.

[30] *USTA Petition* at 6-7.

[31] *BCR Petition* at 6.

[32] *AT&T Petition* at 18-25. The 10.1% and 10.09% measurements were contained in AT&T's Comments in CC Docket No. 79-187 at 40-44 (filed November 13, 1979).

[33] *Restitution Decision* at paras. 10-11.

[34] *Id.* at para. 15.

formally been placed on notice [35] that it was in violation of the Docket No. 20376 prescription orders. The measurements that were rejected in the Restitution Decision were not based upon actual, complete data that were applicable to the calendar year ending December 31, 1978. Because no petitioner sought to contest substantively our rejection of two measurements (*viz.*, 10.02%, 9.89%) that were based upon AT&T's proffered "IDC" adjustments,[36] the only remaining issue is whether we

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[35] *See* December 20 Bureau Letter, *supra*:

"This letter is addressed to the Bell System's rate of return. The most recent financial data reported and our calculations indicate that the Bell System rate of return from interstate and foreign operations presently exceeds the 9.5 to 10.0 percent range prescribed by the Commission in its Docket 20376 Decision in 1976. For the 9-month period ending September 30, 1978, Bell System interstate monthly reports show a cumulative rate of return of 10.42 percent. Even if this figure should be adjusted downward to account for substantial implementation of the Docket No. 19129, Phase II Decision, 64 FCC 2d 1 (1977), the cumulative rate of return yield, according to our calculation, is in excess of 10.1 percent for that time period. Projecting the continued improvement in earnings observed during the past several months, it appears that this figure is likely to increase even more; and perhaps substantially so.

We are presently convinced, therefore, that the Bell System is currently in violation of the Commission's prescription Order in Docket No. 20376. There is no apparent reason to believe that this situation will necessarily be corrected naturally by current or future market conditions; or, that the Bell System is considering decreases in rates or other remedial actions. Of course, the staff is required to interpret, and the Bell System is bound to comply with, the Commission's 1976 rate of return prescription until such time as the Commission may modify its Order. . . ."

[36] *See Restitution Decision* at para. 11, n.14, and Appendix A. AT&T's Petition contains the additional measurement of 10.0859%, which with the IDC decrement of 0.20% would become 9.8859%. For the reasons that are discussed herein and in the *Restitution Decision*, we also reject those measurements.

correctly rejected the "FDC 7" measurements that AT&T provided.[37]

10. AT&T contends in its Petition that we "ignored" its "recast" December 1978 IMR No. 1 data (*e.g.*, the AT&T FDC 7 measurements), and that we "adopted a measure" that we "knew to be incomplete."[38] Those statements are not correct.[39] The *Restitution Decision* did not "ignore" AT&T's "recast" data,[40] but expressed our considered opinion that AT&T's "recast" data should be accorded no weight.[41] Our reasons for this assessment are based principally on defects in the methodologies that AT&T has employed in developing its alternative measurements, as well as on express representations by AT&T that 10.22% accurately stated its interstate rate of return. On June 29, 1979, AT&T filed its "1978 Annual FDC Report." That report, which was based upon data for the month of June 1978, purported to show the rate of return that AT&T had earned during the 1978 calendar year on its interstate services. The "recast" data included interstate investment, expenses, and revenues that had purportedly not been included in the prior IMR 1 reports that AT&T had supplied to this Commission. Specifically, AT&T stated that the IMR 1 did not include investment, revenues, or expenses that were incident to the provision of interstate services at "non-uniform" rates.

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[37] *See Restitution Decision* at paras. 12-14.

[38] AT&T Petition at 24. Other petitions raise the same point. Our discussion here of AT&T's contentions also addresses related issues that were raised by other petitioners.

[39] *See Restitution Decision* at para. 12.

[40] We requested public comment on those data in the *Notice of Inquiry*. *See Common Carrier Interstate and Foreign Earnings* (CC Docket No. 79-187), 75 FCC 2d 412, 413-14, 418-20 (1979).

[41] *Restitution Decision* at para. 15, n.19.

11. In the *Notice* in this proceeding, we sought comment upon AT&T's recast of its December 1978 IMR No. 1 conclusions, after noting: (1) that AT&T's 1978 Annual FDC Report had employed cost allocations that had not been approved by the Commission;[42] and (2) that we had theretofore expressed our concerns with respect to AT&T's implementation of the costing methodology that we had adopted in Docket No. 18128.[43] None of the parties filing comments in response to the *Notice* attempted to perform any sort of quantitative analysis that would have supported the use of AT&T's "1978 Annual FDC Report" as the basis for measuring AT&T's earned interstate rate of return during 1978. Even AT&T's comments, which were in very large measure directed to other reasons why this Commission should not attempt to effect restitution, did not attempt to defend AT&T's 1978 Annual FDC Report from the critical perspectives that had been identified in the *Notice*. In the *Restitution Decision*, we noted that AT&T's *post hoc* "recast" was not based upon data for the entire calendar year, and that the manner in which data was "annualized" was not credible.[44]

12. In addition, our *Restitution Decision* recited statements that had been made by AT&T that expressly stated that 10.22% was the correct measurement.[45] In its January 19, April 20, and May 30 letters, AT&T did not state, or otherwise give any indication, that services were being provided at non-uniform rates that would require

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[42] *Notice* at 413-14, 418-20 (1979).

[43] *See id.* at 414. The Docket No. 18128 costing methodology was to form the basis for the annual cost of service report that AT&T was to file with this Commission.

[44] *Restitution Decision* at para. 12, and nn.15-17.

[45] AT&T asserts that the scope of the 1975 and 1976 Docket No. 20376 prescription orders were not confined exclusively to services that were provided at "uniform" rates. *AT&T Petition* at 18-24.

a 0.10% decrement from the earned rate of return that AT&T had reported on its IMR No. 1. Instead, AT&T contended that: (1) Interest During Construction required a downward adjustment of 0.20% to the rate of return reflected in the December 1978 IMR 1 Report;[46] and (2) changed economic and financial conditions required a higher rate of return.[47] On May 31, 1979, the Commission held a public meeting that discussed AT&T's earnings measurements and the possibility of refunds. Thereafter, on June 29, 1979, AT&T filed a "1978 Annual FDC Report" that purported to show an interstate rate of return of 10.1% for the calendar year ending December 31, 1978.

13. After the FDC Report had been filed and in response to specific questions that were raised by the Common Carrier Bureau with respect to the inconsistent data that had been received, AT&T stated:

> [Your staff] earlier this week asked us to confirm in writing our position regarding the interstate rate of return for 1978.
>
> AT&T reports monthly to the Commission the interstate rate of return consistent with the Commission's past decisions. . . . The report on which the interstate rate of return is shown is the interstate Monthly Report No. 1. The December 1978 Interstate Monthly Report No. 1 showed the interstate rate of return for 1978 to be 10.22%. . . .
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> * * * *
>
> [T]he rate of return of 10.22% shown on the December 1978 Interstate Monthly Report No. 1 is the rate of return for 1978 based on the Commission's directives appropriate to that year. . . .

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[46] *See Restitution Decision* at para. 11, n.14 and Appendix A.

[47] *See id.* at para. 20 and nn.33-34 and AT&T Petition for Determination of a Fair Rate of Return (filed March 8, 1979), CC Docket No. 79-63.

On September 27, 1979, the following question was propounded to AT&T:

> Please state: (1) what total revenues for 1979 would have been required to achieve an after tax rate of return of 10.00% and (2) the income tax rates (federal, state, and, if applicable, municipal) which have been applied *to any revenues which have resulted in earnings in excess of the 10.00% rate of return specified in Docket No. 20376.*[48]

AT&T replied:

> [P]ursuant to your request, we have computed the revenues that would have been required to achieve an after-tax rate of return of 10.0% for the year 1978. The data utilized in the attached analysis indicates that *the revenues required to achieve a 10.0% return would have been $101.0 million less than the revenues shown on the Interstate Monthly Report No. 1 for the year 1978* as issued by AT&T on January 22, 1979.[49]

The preceding recital reaffirms our previous conviction to rely on AT&T's representations in its IMR 1 concerning its interstate rate of return and not to credit subsequent information that is inconsistent with these representations.[50] The information that has been provided during this investigation has been uniquely in the possession and control of AT&T. AT&T developed the IMR No. 1

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[48] Letter from Mr. Glenn deChabert, F.C.C. Common Carrier Bureau, to Mr. Thomas E. Lawrence, AT&T, dated September 27, 1979.

[49] Letter from Mr. Thomas E. Lawrence, AT&T, to Mr. Glenn deChabert, F.C.C. Common Carrier Bureau, dated October 26, 1979.

[50] As a matter of public policy, resolving inconsistent information against the party providing that information provides an incentive for parties to be more accurate in their representations to this Commission. *RKO General, Inc. v. FCC*, 670 F.2d 215, 231-36 (D.C. Cir. 1981).

earnings report, and has presented it to this Commission for a period in excess of twenty-eight years. After formal inquiry issued from the Common Carrier Bureau concerning AT&T's earnings reflected in those reports AT&T: (a) sought to have the Commission award it a rate of return in excess of the rate of return that had been shown on the December 1978 IMR No. 1 Report;[51] (2) sought to introduce "adjustments" to the IMR 1 data in the form of: (a) IDC adjustments ("full compliance with Docket 19129 (Phase II) requirements"; *see Restitution Decision* at Appendix A); and (b) *ad hoc* adjustments for interstate services that were provided at "non-uniform" rates during a period when AT&T and the BOCS had been providing interstate telecommunications services under tariffs that we had found to be unsupported and unlawful (*see Restitution Decision* at Appendix B). AT&T's numerous statements as to the scope and content of the IMR No. 1 *and* the amount of interstate revenues by which AT&T and the BOCS had exceeded the upper bound that had been ordered in Docket No. 20376 contradict AT&T's efforts to derogate the IMR No. 1 as the measurement of AT&T's interstate earnings. As a consequence, we deny those requests that seek to have us conclude that the 10.22% figure is not a proper measure of AT&T's interstate rate of return for 1978 and is not binding upon AT&T and the BOCS.

B. *Legal Issues*

14. Several petitioners[52] question the legal premises that are embodied in, or that relate to, the *Restitution*

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[51] *See* para. 12, n. 48, *supra*.

[52] AT&T Petition at 1-9; AT&T Response to Petitions For Reconsideration (filed March 1, 1985); Bell Atlantic Petition at 5-7; BCR Petition at 1-6, 11-14; GTE Petition at 6-21; RTC Petition at 1-14; USTA Petition at 1-6; U.S. West Petition at 3-7.

Decision.[53] USTA reasserts its contention that the Communications Act does not comprehend the prescription of rates of return, and that in some sense, the restitution mechanism that we established constitutes retroactive ratemaking.[54] With respect to both of these contentions, USTA has not offered anything that was not before the Commission at the time that we adopted the *Restitution Decision.*[55] First, the ability to prescribe rates of return

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[53] This section of our *Reconsideration Order* addresses only those legal issues that pertain directly to the restitution obligations of AT&T and the BOCs. Those legal issues that are unique to the Independent telephone companies are addressed in the section captioned "Apportionment of the Restitution Obligation" of this decision, *infra.* For the purpose of this *Reconsideration Decision,* an "Independent" telephone company is a non-AT&T/BOC telecommunications exchange common carrier that received interstate revenues that were derived from AT&T/BOC tariffs during 1978.

[54] *USTA Petition* at 4-5. *But see Nader v. FCC,* 520 F.2d 182, 187-204 (D.C. Cir. 1975) (*"Nader"*).

[55] *See Restitution Decision* at paras. 21-22, and nn.37-42. Section 205(a) of the Communications act expressly states that the Commission is empowered "to determine and prescribe what will be the just and reasonable charge or the *maximum* or minimum, or maximum and minimum charge or *charges to be thereafter observed, and what classification, regulation, or practice is or will be* just fair and reasonable, to be *thereafter followed.* . . ." 47 U.S.C. § 205(a) (1975) (emphasis supplied). GTE makes arguments (GTE Petition at 6-10), that are somewhat analogous to those of USTA, arguing *inter alia,* that 205(a) is prospective in effect, which is irrelevant since the *Restitution Decision* involved the enforcement of an outstanding order that was by its terms prospective in effect. *See AT&T Co.* (Docket No. 20376), 57 FCC 2d 960, 973 (1976), *Restitution Decision* at para. 20. GTE further argues, citing *Arizona Grocery,* that "charges once authorized by the Commission remain in effect as the sole lawful rates until new charges are lawfully prescribed. These new charges may relate only to the future, and they may not in any way imply that prior rates were invalid or be set to redress such perceived invalidity." *GTE Petition* at 7. This Commission did not "authorize" the charges that resulted in the excess revenues during 1978. *Restitution Decision* at paras. 21-22

is essential to ensuring that rates are, in the aggregate, "just and reasonable." [56] This is particularly true in an

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and Appendix B. However, the Commission did prescribe the maximum rate of return that could be received from interstate services. *AT&T Co.* (Docket No. 20376), 57 FCC 2d 960, 973 (1976). GTE's reference to "lawful rates" is both misleading and incorrect. *See Las Cruces TV Cable v. FCC*, 645 F. 2d 1041, 1044 (D.C. Cir. 1981) ("In the argot of ratemaking, a "legal" rate is one filed by the regulated firm with the regulatory agency and not held by that agency to be invalid. A 'lawful' rate is a legal rate that the regulatory agency has upheld as valid. *See Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Railway Co.*, 284 U.S. 370, 383-86 . . ."); *Restitution Decision* at para. 21 and Appendix B. *See* Section 1.52 of the Commission Rules, 47 C.F.R. § 1.52 (1984). GTE's statement (GTE Petition at 8) that "[t]he Commission's refund order is also contrary to Section 205 because the adjustment of charges contemplated in the order will presumably occur without hearings" is also inapposite, since the *Restitution Decision* provided for a hearing on the charges that would implement that decision to determine: (1) whether the division of the restitution obligation among carriers was appropriate; and (2) whether the tariffs that incorporated the provisions of the *Restitution Decision* were "just and reasonable." *Restitution Decision* at para. 18, n. 25, para. 25; *Order Denying Requests for Stay* (CC Docket No. 79-187), FCC 85-40 at para. 4 n.9 and paras. 7-9. GTE's contention that the Commission's restitution mechanism constitutes "retroactive ratemaking" (*GTE Petition* at 11-14) is not grounded in case law that corresponds with either the facts or circumstances that apply to the *Restitution Decision.* Without unnecessarily belaboring the point, the cases that GTE cites that address "retroactive ratemaking", evolve, in general, from circumstances in which the regulatory body actually set the specific price, or "charge", that was to be paid by the user of the regulated entity's service. As noted earlier, that is not the case here. The other cases cited by GTE involve fact patterns or statutory issues that are readily distinguished from, and therefore not analogous to, the considerations, facts, or procedures that were present in the *Restitution Decision.* The other legal issues that GTE has raised with respect to the Independent telephone companies are discussed in the separate section of this order that discusses the apportionment of the restitution obligation.

[56] *See* Sections 201, 204-205 of the Communications Act of 1934, as amended, 47 U.S. §§ 201, 204-205 (1978).

environment where fungible plant is used to provide a variety of services simultaneously.[57]

15. Second, it is difficult to comprehend the basis for USTA's contention that our action constitutes "retroactive ratemaking." The cases cited by USTA in its petition and earlier comments [58] that would seem to bear on this point presuppose prices that were either fixed, prescribed, or approved by the regulatory authority. That certainly is not the case here.[59] USTA also states that "the effect of a rate of return 'prescription' has been consistently viewed by the Commission as a bar to a tariff filing designed to produce a rate of return above the 'pre-

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[57] *See Restitution Decision* at para. 21, n.38; and Appendix B, para. 8; *In the Matter of Investigation of Access and Divestiture Related Tariffs AT&T Communications Private Line Services* (CC Docket No. 83-1145, Phase II, Tariff FCC No. 3 and Tariff FCC No. 6), FCC 84-292, Appendix (released February 14, 1985).

[58] *See USTA Petition* at 6, n.*; USITA comments at 3-7, 15-16. (USTA states that it is the successor organization to USITA, and, as such incorporates by reference all statements made by USITA). For example, USTA relies on *T.W.A. v. Civil Aeronautics Board*, 336 U.S. 601 (1949). But that opinion *begins* by stating:

> [T]he question in this case is whether the Civil Aeronautics Board has authority to fix a new mail rate for air carriers and to make it retroactive for a period in which a final rate *previously fixed by the Board* was in effect and unchallenged by the initiation of a mail rate proceeding. . . .

[59] *See Restitution Decision* at para. 21 and nn. 37-40, and Appendix B. On pages 13 and 14 of its petition, USTA states that Section 201(a) is not available to the Commission as a vehicle for apportioning carrier restitution obligations. In a recent order in this proceeding, we addressed the substance of USTA's contentions with respect to Section 201(a). *See Order Denying Requests for Stay* (CC Docket No. 79-187), FCC 85-240 at paras. 7-9, and nn.9-11, 16-22 (released May 10, 1985); "GTE's Motion For Clarification of Issues and Procedures And For Supplementation of the Record."

scribed' rate, not as a basis for ordering refunds." [60] While USTA is correct in observing that, in the first instance, tariffs are required to be designed to earn the prescribed rate of return, USTA is incorrect in its construction of the prescription orders at issue here. For "targeting" purposes, the prescribed rate of return was not 10 percent, but 9.5%.[61] The clearly stated upper bound upon the earnings that were to be derived from interstate tariffs, however, was, not the "target" rate of 9.5%, but rather the 10 percent limit that had been set upon interstate earnings.[62] Rates were to be targeted to *earn* 9.5%. Restitution would not be required as long as interstate earnings did not exceed 10 percent.[63] As the United States Supreme Court stated in the *Arizona Grocery* case: "[t]he carrier acquires no vested right in any income in excess of a reasonable return on its investment." [64] The maximum "reasonable return" upon that interstate investment was 10 percent.[65]

16. Bell Atlantic, the BCR Attachment A Companies, and GTE contend that we may not rely upon sections 205(a) and 4(i) of the Communications Act in effecting

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[60] USTA Petition at 5 (footnote omitted). *Compare Las Cruces TV Cable v. FCC*, 645 F.2d 1041, 1043 (1981) (refunds ordered under rates found by the Commission to be other than just and reasonable); *Restitution Decision* at para. 21 and Appendix B.

[61] *AT&T Co.* (Docket No. 20376), 57 FCC 2d, 960, 973 (1976). *See Memorandum Opinion and Order* in Docket No. 20732, 58 FCC 2d 1 (1976).

[62] *Id. AT&T Co.* (Docket No. 20376), 57 FCC 2d 979, 1004-05 (1975).

[63] *Id. Compare Arizona Grocery v. Atchinson, Topeka & Santa Fe Railway Co.*, 284 U.S. 370, 373-74 (1931) (*"Arizona Grocery"*).

[64] *Arizona Grocery, supra*, at 373.

[65] *AT&T Co.* (Docket No. 20376), 57 FCC 2d 960, 973 (1976).

restitution.[66] Our earlier orders in this proceeding address those concerns. *See Restitution Decision* at paras. 20-22; *Order Denying Requests for Stay* (CC Docket No. 79-187), *supra*, at paras. 7-11.[67] For most of these concerns, little, if anything, would be gained by restating the reasoning that is contained in those earlier orders. One issue that merits further amplification, however, concerns the requirement of an "opportunity for a hearing" that Bell Atlantic notes is contained in Section 205(a) of the Act.[68] Other petitioners[69] contend in a variety of statutory contexts (*e.g.*, expressly, with respect to Sections 204 and 205; and by implication, with respect to Sections 207-209 of the Communications Act) that one or more additional "hearings" are required before the Commission may effect restitution in the manner provided in the *Restitution Decision*.

17. As noted earlier,[70] the Commission was engaged in an investigation of AT&T's interstate earnings at the time that the GSA Petition was filed.[71] AT&T had

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[66] Bell Atlantic Petition at 5-7; BCR Petition at 3-4; GTE Petition at 14-15.

[67] In this regard, we note that neither GTE nor Bell Atlantic has provided any additional information that was not comprehended in the pleadings that were filed in response to the initial *Notice*. Bell Atlantic's analysis included a section that suggested that its operating telephone companies had achieved interstate rates of return during 1978 that were at variance with the annual rate of return that AT&T reported to this Commission for the calendar year ending December 31, 1978, and therefore that it should be excluded from any part of the restitution obligation. We address this contention in a later section of this Decision. *See* "Apportionment of the Restitution Obligation", *infra*.

[68] Bell Atlantic Petition at 5.

[69] *Id.* at 5-6; AT&T Petition at 1-18; BCR Petition at 11-14; GTE Petition at 6-21; US West at 4-7.

[70] *See* paras. 2-4 and n.7, *supra*.

[71] *Id. See Restitution Decision* at para. 1, n.1; Sections 403, 412 of the Communications Act of 1934, 47 U.S.C. § 403, 412 (1978).

actual knowledge, not later than December 20, 1978, that an investigation of its interstate earnings was in progress.[72] In response, AT&T filed the information that is discussed at paras. 3-14, *supra;* and in the *Restitution Decision* at paras 10-15 and Appendix A. In the *Restitution Decision,* we resolved the conflicting information that AT&T provided during the course of that investigation by finding that AT&T had earned a 10.22% rate of return on interstate services during 1978. *Restitution Decision* at para 15, n. 19. No further hearing was required with respect to that information. *Id.* We did, however, in the *Notice* which was released in 1979, request comments on alternative restitution mechanisms and the costs of effecting restitution under those, and other, methods.[73] At that time, we also sought comments on several related matters[74] in light of broader policy issues that concerned the inadequacy of the data that AT&T had been providing in its tariff filings, claims that AT&T's telecommunications plant was under-depreciated, and collateral contentions that AT&T had filed during the spring of 1979 asserting that its cost of capital had increased.[75] The comments in response to that *Notice* indicated that the most inexpensive mechanism for effecting restitution was through the vehicle of a temporary discount.[76] However, in light of changes in the telecommunications industry since the *Notice* was issued, we decided in the *Restitution Decision* to seek further comments on the manner in which we had divided the

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[72] Letter from the Acting Chief, Common Carrier Bureau to Mr. William Stump, AT&T, (December 20, 1978).

[73] *Notice,* supra, at 415-16 para. 7.

[74] *See Notice* at paras. 3-8.

[75] AT&T Petition for Determination of Fair Rate of Return filed in Cc Docket No. 79-63 (March 8, 1979). *See AT&T Co.* (Order Designating Hearing), 73 FCC 2d 689 at para. 1, n.3, 690-94 (1979).

[76] *AT&T Comments* at Attachment (filed November 19, 1979).

restitution obligation among carriers that had derived revenues from AT&T's tariffs during 1978,[77] and whether the tariffs filed to implement our *Restitution Decision* were "just and reasonable" within the meaning of the Communications Act.[78] Those comments did not suggest, except as far as the Independent telephone companies were concerned,[79] that the division of restitution obligations established in the *Restitution Decision* was, in any material respect, incorrect, or that the tariffs were other than "just and reasonable." [80] We thus conclude that we have provided an adequate opportunity for interested parties to be heard.[81]

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[77] *Restitution Decision* at paras. 17, 25.

[78] *Id.*

[79] *See* "Apportionment of the Restitution Decision," *infra.*

[80] Under Section 1.773 of the Commission's rules, 47 C.F.R. §§ 1.773 (1984), the public has also been afforded the opportunity to comment upon the tariffs that have been filed and the adequacy of the cost support that is related thereto.

[81] As the Court stated in *American Telephone and Telegraph Co. v. FCC*:

> [C]ertainly AT&T had a "full opportunity for hearing." It participated in all three rounds of comments, and after the FCC's initial Report, it filed both a petition for reconsideration and replies to comments made by other parties regarding the various petitions for reconsideration. AT&T may not complain that it had anything less than a "full opportunity" to be heard.

572 F.2d 17, 22 (1978). AT&T has contended, as U.S. West and AT&T contend in their reconsideration petitions here, that an additional hearing was required with respect to changed economic and financial circumstances or, in the alternative, that we incorrectly disregarded evidence that AT&T had provided to the effect that economic and financial conditions had changed so drastically between 1976 and 1978 that the Docket No. 20376 prescription orders had lapsed. We rejected those contentions in the *Restitution Decision* at para. 20 and nn.33-35. Economic and financial conditions are never *totally* static. It is thus necessary to look at the range of economic and financial conditions that obtain with respect

to the periods that are subject to comparison. The petitioners fail to take into account the entire record that was before us and the Administrative Law Judge, at the time that we ruled on exceptions to the Administrative Law Judge's initial decision in *early* 1976, as well as other information and data that relate to 1978, including AT&T's Petition for Determination of a Fair Rate of Return in CC Docket No. 79-63 and exhibits filed therewith. Without referring to all of the evidence that was before the Commission with respect to the contested time periods here, we simply note that the reported decisions of the Commission establish the fact that aggregate economic and financial conditions, as well as those that pertained particularly to AT&T, were, during 1978, within the range of conditions that we considered in setting the rate of return prescription during January and early February, 1976. *See Initial Decision of Administrative Law Judge Byron E. Harrison* in Docket No. 20376, 57 FCC 2d 979, 981-1005 (1975); *AT&T Decision* in Docket No. 20376, 57 FCC 2d 960, 962-77; *AT&T Decision* in Docket No. 79-63, 86 FCC 2d 211, 234 (1981). Several petitioners allude to the *Comsat* decision, 68 FCC 2d 941, 942, 950 (1978) (*"Comsat"*) as providing *a fortiori* support for the proposition that *AT&T's* cost of capital had changed substantially enough to have vacated the Docket No. 20376 prescription orders. We reject that inference. The linkages between Comsat's cost of capital determination and AT&T's cost of capital are not, and were not, direct. *See Restitution Decision* at para. 20, nn.30-37 and references cited therein. Comsat's cost of capital revision was predicated upon the application of a risk premium that was considered to have been *invariant with respect to Comsat* under circumstances that were obviously different. *Compare id., Comsat* at 950. The evidence of record in CC Docket No. 79-63 did not support such a conclusion with respect to AT&T. *See AT&T Decision* (Docket No. 79-63), 86 FCC 2d 257, 270 ("The risk premium found for the twenty-year period averaged 5.6 to 5.7 percentage points. Additionally, analysis of a more recent five-year period indicated an average risk premium of 6.5 to 6.6 percentage points.") Nor did we conclude, after trial, that any of the specific measurements that were contained in *AT&T's Petition for Determination of a Fair Rate of Return* in CC Docket No. 79-63 (filed March 8, 1979) were either accurate or otherwise correct. *AT&T Petition for Determination of a Fair Rate of Return* in CC Docket No. 79-63 (filed March 8, 1979). *See AT&T Decision* in Docket No. 79-63, 86 FCC 2d 221-282 (1981). *Compare Comsat*, 68 FCC 2d at 950 (1978). We thus conclude that U.S. West's contention is without merit. *See* U.S. West Petition at 7, n.13.

18. AT&T also contends that the Commission's consistent policy has not been to treat its determinations of authorized rates of return as ceilings on earnings that cannot be exceeded, but merely as "targets" for future ratemaking. AT&T complains that the Commission had arbitrarily reversed that "policy" without adequate notice.[82] An objective reading of the decisions that AT&T cites does not support AT&T's contentions, particularly when related decisions, and other portions of the cited decisions are considered in context.[83] For example, during 1973 we stated:

> [e]ssentially that range (*e.g.*, our prescription of 8.5-9.0% as the prescribed range) is intended as our criteria for measuring the reasonableness of AT&T's interstate rates and earnings and the need for adjustments therein. Assuming, therefore, that AT&T's rates were reasonably designed to strike a

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[82] *AT&T Petition* at 3-9.

[83] *See AT&T Co.* (Docket No. 16258), 9 FCC 2d 30, 116 (1967); *In Re Rate Reduction for Interstate Long-distance Telephone Calls*, 21 FCC 2d 654 (1969); AT&T Co. (Docket No. 19129), 38 FCC 2d 213, 226-27, 245 (1972); *AT&T Co.* (Docket No. 20376), 51 FCC 2d 619, 625 (1975); *AT&T Co.* (Docket No. 20376), 57 FCC 2d 960, 960-61 (1976). For example, AT&T's reference to Docket No. 16258, 9 FCC 2d 30, 115-16 (1967), does not refer to the fact that the Commission required a prospective reduction in rates, after having determined that AT&T's interstate earnings had exceeded the allowable rate of return of all of AT&T's interstate services earnings. *AT&T Co.* (Docket No. 16258) at 114, para. 333. In the second decision cited by AT&T, *In Re Rate Reduction for Interstate Long Distance Telephone Service*, 21 FCC 2d 654 (1969), the Commission stated "[i]n view of these uncertainties, the Commission wishes to make clear that the views expressed herein relate to the current situation and cannot be binding under any future changed economic conditions." *Id.* at 656. AT&T's construction of our Docket No. 19129 decision, 38 FCC 2d 213, 226-227, 245 (1972), is also not supported by an objective reading of the portions of that Decision that AT&T cites.

> going level of earnings of 8.5%—and we believe this to be a reasonable assumption—our Decision does not prohibit earnings *up* to 9.0%.

AT&T Co. (Docket No. 19129), 42 FCC 2d 293, 300 (1973) (emphasis added). If the concept of a limit to the amount that AT&T could earn on its interstate operations was not sufficiently clear at that point, the United States Court of Appeals for the District of Columbia Circuit stated:

> [W]e would be shirking reality if we did not recognize that the practical effect of the Commission's Phase I order *was to limit prospectively AT&T's rate of return to 8.5%.*

Nader v. FCC, 520 F.2d 182, 201 (1975).

The Court further stated:

> [t]herefore, when the Commission ruled that AT&T could earn a return of 8.5 and allowed AT&T to increase its revenues by $145 million to achieve that return, the Commission necessarily must have intended its decision and order to have the prospective effect of a prescription, thus, limiting the utility to that return.

Id. at 202. The Administrative Law Judge's Initial Decision in Docket No. 20376 with respect to the maximum rate of interstate earnings that AT&T could receive was explicit: "[T]he Presiding Judge is recommending an overall rate of return *not to exceed 10%.*" *Initial Decision of Administrative Law Judge Byron E. Harrison in Docket No. 20376*, 57 FCC 2d 979, 1002 (1975) (emphasis added). *See also id.* at 1004-05. And in affirming the Administrative Law Judge's finding as to the rate of return, we stated that AT&T should be permitted "a level or range of interstate earnings *not to exceed* 10%." *AT&T Co. Decision* (Docket 20376), 57 FCC 2d 973. As a consequence, we believe that, contrary to AT&T's

assertions, our decision to require AT&T to restore excess revenues was not based upon a novel policy of which AT&T had no notice.

C. *Policy Issues*

1. *Remedies*

19. The *Notice* in this proceeding requested comments on alternative remedies that might be utilized to effect restitution.[84] The discussion of those alternatives in the *Notice* was grounded on our acute concern that the mechanism of effecting restitution could conceivably cost more than the amount subject to restitution. The comments that were filed in response to that *Notice* stated: (1) that crediting excess revenues to AT&T's accumulated depreciation reserve account would entail a variety of evidentiary, accounting, and jurisdictional separations issues that would impede effecting restitution;[85] and (2) that direct credits to each customer's bill would be more expensive than providing a discount on future services.[86] Our decision in the *Restitution Decision* to employ a temporary discount on future services was based on these

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[84] *Notice* at 415-16.

[85] AT&T Comments at 45-46; United States of Consumer Affairs Comments at 6-7 ("USOCA Comments"); Comments of the NCCB at 10-11.

[86] As the United States Office of Consumer Affairs stated:

> The practical difficulties inherent in attempting to track revenues received from individuals may make [direct refunds] an impractical solution. Indeed, with some over-collections the cost of determining and refunding to each customer the amount the customer overpaid would exceed the amount of the refund.

USOCA Comments at 4-5 (filed November 14, 1979). On the problems that were associated with effecting direct refunds, the NCCB was more explicit, stating that direct refunds were a "practical impossibility." Comments of the NCCB at 12. *See also* Comments of AT&T at Attachment (filed November 13, 1979).

views in the record [87] and on our own independent judgment that this mechanism was the least expensive, and most efficient, approach to effecting restitution.[88]

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[87] It was these concerns, in part, that led us to avoid relying on the accounting orders that are discussed in Appendix B of the *Restitution Decision* in formulating the restitution mechanism. *See Restitution Decision* at paras. 17-19 and Appendix B. Our decision to employ as part of that mechanism the common NECA tariff filing that is required to be made each year under our rules was also based upon these concerns. *See* Section 69.3 of the Commission's rules, 47 C.F.R. § 69.3 (1984). *See generally,* parts 61 and 69 of the Commission's rules, 47 C.F.R. §§ 61.1-61.193, 69.1-69.610 (1984). Rather than requiring many exchange telephone companies to file individual tariffs reflecting restitution in separately tariffed charges and associated cost support materials, it was more efficient, less expensive, more timely, and administratively less difficult to determine whether restitution had been effected properly in the context of the scheduled filing of the annual NECA tariff revision. *See Restitution Decision* at paras. 17-18, 25 and nn.25-26. *See also* AT&T Comments at 49-50 (filed November 13, 1979).

[88] *See id., Restitution Decision* at paras. 17-19 and notes contained therein. We did not elect to establish one or more funds for consumer representation in light of comments that had been received suggesting that consumer representation funding was only merited if direct restitution to ratepayers could not be effected. *Id.* Furthermore, it is axiomatic that excess revenues that are received from interstate customers, in violation of FCC orders, belong to the customers from whom they were received. *See id.* We did not, at the time of the *Restitution Decision,* nor do we now, believe that those revenues properly belong to anyone else. While the relief we have ordered provides restitution to current, rather than 1978, interstate ratepayers, we perceive that there is a substantial overlap between these two groups of consumers of interstate services and that this form of relief is more consistent with our restitutionary obligations than directing that funds be paid to spokespersons or organizations purporting to act on these consumers' behalf. As the United States Office of Consumer Affairs ("USOCA") stated: "It is important to remember that what is at stake is money that rightfully belongs to individual consumers." USOCA Comments at 6. Thus, our obligation is, in the first instance, to restore the excess revenues that were received to ratepayers. *Accord.,* Comments of USOCA and NCCB. If ratepayers subsequently choose to use the

20. Moreover, although we expressed concern about the collateral restitution obligations of the Independent telephone companies,[89] we realized that we did not have a record that was sufficient to effect an apportionment of those obligations[90] and that the incidence of the restitution obligation[91] among carriers would have to be separated administratively from the mechanics of effecting restitution,[92] if restitution were to be accomplished in a timely manner. We thus structured a remedy that was carefully designed to effect restitution in an efficient, economical, and fair manner.[93] Two petitioners have requested, however, that we restructure our remedy in a manner that would be more conducive to their respective interests.[94]

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savings from the rate reductions we have ordered to fund consumer representation in ratemaking proceedings, they will, of course, be able to do so.

[89] *See Restitution Decision* at paras. 1, 17, 19, and notes cited therein.

[90] *Id.* at para. 17, n.25; para. 19, n.28; and para. 25.

[91] *Id.* at para. 25.

[92] *Id.* at paras. 17-19 and n.27. *Order Denying Requests for Stay* in CC Docket No. 79-187, FCC 240, at paras. 7-9 and n.20 (released May 10, 1985).

[93] Public comment on the tariffs that implement the *Restitution Decision* has been sought in the context of this proceeding, as well as in the context of the normal comment cycle that applies under our rules for tariffs. *See Restitution Decision* at para. 25. With the exception of concerns raised by Independent telephone companies about the imposition of restitution obligations on them and certain competitive concerns raised by interexchange carriers other than AT&T, no party has questioned the justness or reasonableness of that portion of the tariffs that have been filed to implement the *Restitution Decision* or the division of the restitution obligation among AT&T and the exchange carriers that are reflected in those tariffs.

[94] U.S. West Petition at 7-8; SBS Petition at 5-8.

21. U.S. West has suggested that exchange carriers be permitted to retain their respective shares of their restitution obligations and apply the amounts thus obtained "as part of the funding of 'lifeline' service." [95] While lifeline programs serve an important public purpose,[96] there is not necessarily a close match between the beneficiaries of such programs and the group of interstate ratepayers from whom the excess revenues were extracted. We see our objective here as, to the extent possible, providing restitution to those interstate ratepayers and not as providing funding for other, ableit worthy, purposes.

22. Satellite Business Systems ("SBS"), an interexchange services competitor of AT&T, contends that by requiring that AT&T "flow through" its restitution obligation to its customers, we are according "an unjustified preferential status to AT&T's subscribers at the expense of [other interexchange common carriers] customers who are equally entitled to benefit from the restitution of this sum." [97] In essence, SBS objects to that portion of the *Restitution Decision* that requires AT&T to reduce its rates by its share of the total restitution obligation.[98] For competitive reasons, SBS would prefer that we order AT&T to pay its share of the restitution obligation to

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[95] U.S. West Petition at 7.

[96] See Section 69.203(f) of the Commission's Rules, Amendments to Part 69, 50 Fed. Reg. 944 (to be codified at 47 C.F.R. § 69.203(f)).

[97] SBS Petition at 5. *See* SBS Petition at 6-8 ("By flowing through the entire restitution amount to the benefit of AT&T's customers while applying only one portion of this sum to the benefit of OCC subscribers, the Commission has enabled AT&T to propose rate reductions that are not cost-justified and are disproportionate in size to those that might be effected by the OCCs as a result of the restitution.")

[98] SBS Petition at 5.

the NECA, which would then file a further reduction in exchange carrier access tariffs.[99]

23. We have conclude[d] that it would not be appropriate to modify our *Restitution Decision* as suggested by SBS. SBS has not demonstrated that the "retargeting" that would result from SBS's proposed redirection of AT&T's restitution obligation would be more closely aligned with the composition of the 1978 ratepayer body from whom the excess revenues were received.[100] Second, while competition will generally ensure the flow-through of OCC cost savings, it is not clear that a modification to our restitution plan that had the effect of lowering OCC costs, but increasing AT&T's rates (as compared to those costs and rates under our current plan), would necessarily result in a lowering of rates to OCC customers as SBS implies. Moreover, the refiling of the existing NECA tariffs and cost support materials, as well as AT&T's tariffs, would impose additional burdens upon the Commission, the NECA, AT&T, and the commenting public, as well as result in further delay in effecting restitution, that would not be offset by concommitant benefits to the public.[101]

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[99] *Id.* at 7.

[100] In this regard we note that SBS has not provided information as to the composition of subscribers to AT&T's interexchange services during 1978, as contrasted with those of AT&T and the OCCs during the 1985-1986 restitution period. We do know from other OCC and AT&T filings before this Commission that various OCCs were during 1978, and are now, customers of AT&T's interstate, interexchange services. We are also aware that these were OCC subscribers during 1978, which presents the possibility that some of those subscribers may not have used any of AT&T's interstate, interexchange services during 1978, when AT&T received the excess revenues that are the subject of the *Restitution Decision.*

[101] SBS has not demonstrated that AT&T's competitors would be so adversely affected that the competitive consequences of the *Restitution Decision* would outweigh the advantages to the public of the tariffs that have already been filed. *See* SBS Comments at 1-9.

B. *Apportionment of the Restitution Obligation*

24. In the *Restitution Decision*, we apportioned the total restitution obligation into an AT&T obligation that was imposed as a reduction in AT&T's revenue requirement for interstate services and an exchange carrier obligation that was imposed as a deduction from exchange carrier common line charges ("carrier common line restitution component").[102] We arrived at that initial division because it was clear that the pre-divestiture restituion liability of AT&T and the BOCs was a liability that was joint in nature, derived, as it were, from the interconnected provision of interstate services.[103] It was also clear under the contingent liability provisions of the Plan of Reorganization that AT&T was contractually bound to a share of the restitution obligation that was equal to the proportion that its interstate plan bore, at the moment of divestiture, to the total interstate plant of the pre-divested enterprise.[104] Less clear was the relationship of the Independent telephone companies to a restitution obligation that had been determined on the basis of AT&T/Bell System accounting of 1978 revenues, expenses, and net rate base.[105] Nevertheless, the Independent telephone companies had participated in revenues during 1978 that had been derived from interstate tariffs filed by AT&T that were designed to compensate those companies for the interstate use of their plant for originating, terminating, or otherwise participating in the provision of interstate telecommunications services.[106] It

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[102] *Restitution Decision* at para. 19, and n.28.

[103] *Id.* at para. 17.

[104] *See id.* at para. 19, n.28.

[105] *Restitution Decision* at paras. 1, 10-15, 17.

[106] During 1978, AT&T through the settlements process compensated the Independent telephone companies for the use of their facilities in completing interstate calls.

thus followed that *if excess revenues were received by the Independent telephone companies*, as a consequence of tariffs that had been filed by AT&T, restitution was in order.

25. The record in this proceeding is devoid of any evidence that establishes that the Independent telephone companies earned a rate of return that exceeds the ten percent limit that was prescribed for AT&T. None of the comments that were contained in the Petitions for Reconsideration, Petitions for Stay, or comments that were filed in the "Divisions Proceeding" [107] provide information or support for the proposition that the Independent telephone companies should bear any portion of the restitution obligation that was determined for AT&T and the BOCs.[108] We thus conclude that the NECA shall not deduct, from the distributive shares of the Independent telephone companies that are calculated pursuant to Part 69 of the Commission's rules, any portion of the restitution obligation that was imposed upon the carrier

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[107] The "Divisions Proceeding" was established in the *Restitution Decision* at para. 25, and para. 17, n.25. *See Order Denying Requests for Stay, supra*, at paras. 7-9.

[108] In fact, those filings contained representations that the earned rates of return on interstate services of the Independent telephone companies was less than the 10 percent limit that had been set for AT&T and the Bell System Operating Companies. *See* Reply Comments of the National Telephone Cooperative Association and The Organization for the Protection and Advancement of Small Telephone Companies at 3-4 (filed May 16, 1985); GTE-Petition at 4-6 and Affidavit of William E. Stein. Although USITA participated in the 1975 and 1976 AT&T/Bell System rate of return proceedings, as USITA did in CC Docket No. 79-63, our Docket No. 20376 decisions did not prescribe a separate rate of return limitation upon the interstate operations of the Independent telephone companies. Nor were the costs of capital of the Independent telephone companies expressly at issue in Docket No. 20376. *See AT&T Co.* (Docket No. 20376), 57 FCC 2d 960-73 and references cited therein.

common line pool as a consequence of the *Restitution Decision.*[109]

26. At the time that we adopted the *Restitution Decision,* we had not afforded the public an opportunity to comment on the division of the restitution obligation among AT&T and the exchange carriers. With the exception of Bell Atlantic, none of the parties in this proceeding has contended that the contingent liability provisions that are applicable to AT&T and the BOCs result in an inappropriate allocation of the respective restitution obligations of those parties. Bell Atlantic contended, however, that the 1978 earned interstate rate of return of the Bell Atlantic Operating Companies was less than 10%, and therefore, perhaps as a matter of equity, it should not be required to assume any portion of the restitution obligation.[110] As we have noted earlier, Bell Atlantic was part of the pre-divestiture Bell System, the entity to which our rate of return prescription and determination of excess interstate earnings in 1978 applied. We find it appropriate that the restitution obligation be borne by all the pre-divestiture members of the Bell System. Moreover, nothing further would be gained at this point by the initiation of individual or related allocative proceedings with respect to further reapportionments of the respective restitution obligations of AT&T and the 22 BOCs.

27. AT&T and the BOCs are further bound by the allocative representations, under the contingent liabilities of the Plan of Reorganization, that were made by them in the tariffs that were filed at the Commission to implement the *Restitution Decision.* We see no need to

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[109] *See Restitution Decision* at para. 19. As a consequence of our decision today, the portion of the restitution obligation to be recovered through reductions in carrier common line charges will be borne entirely by the BOCs.

[110] *Bell Atlantic Petition* at 1-4, Affidavit of Edwin R. Burtner.

promote unnecessary litigation in the United States District Courts among the BOCs and AT&T. As a consequence, we further direct that the NECA shall reduce the distributive shares of the BOCs that that are subject to the contingent liability provisions of the Plan of Reorganization by *pro tanto* shares of the carrier common line restitution component [111] that are equal to the amount of each BOC's "relative investment devoted to interstate services as of the effective date of divestiture (as calculated in accordance with the FCC-prescribed Separations Manual in effect on the date of divestiture), adjusted to reflect the assignments of assets under this Plan of Reorganization (CPE and InterLATA assets to AT&T, and intraLATA assets to the BOCs.)" [112]

28. In the *Restitution Decision* and in our actions on reconsideration here, it has been necessary to exercise the discretion that the Communications Act confers upon this Commission. Each case must necessarily be examined on its own merits, with the procedures that are employed and the remedy that is developed being appropriate to the facts and circumstances that are presented.

ORDERING CLAUSES

29. ACCORDINGLY, IT IS ORDERED That the Petitions for Reconsideration ARE GRANTED to the extent stated herein, and are, in all other respects, DENIED.

30. IT IS FURTHERED ORDERED That all other motions or petitions that have been filed in this proceed-

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[111] *See Order Denying Stay, supra,* at para. 8.

[112] *See id.* at paras. 7-10; "Plan of Reorganization", filed in *United States v. Western Electric Co. & AT&T,* C.A. No. 82-0192 (D.D.C., filed December 16, 1982) at 188. This provision applies to those BOCs that are subject to the Modification of Final Judgment that was the basis for the "Plan of Reorganization."

ing ARE GRANTED to the extent indicated or referred to herein,[113] and are, in all other respects, DENIED.

31. IT IS FURTHER ORDERED That the Secretary shall, with the exception of the American Telephone and Telegraph Company and the Bell System Operating Companies, transmit a copy of this decision to the National Exchange Carrier Association and to each of the parties filing comments in this proceeding.

32. IT IS FURTHER ORDERED That the Secretary shall, by registered mail, serve a copy of this decision upon the American Telephone and Telegraph Company and each of the Bell Operating Companies in accordance with Sections 416 and 413 of the Communications Act of 1934, as amended, and shall enter proof of such service in the docket in this proceeding.

33. IT IS FURTHER ORDERED that this proceeding is terminated.

FEDERAL COMMUNICATIONS COMMISSION

WILLIAM J. TRICARICO
Secretary

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[113] In this regard, we incorporate by reference the *Order Denying Requests For Stay* in CC Docket No. 79-187, *supra*.

APPENDIX E

STATUTORY APPENDIX

§ 4 Federal Communications Commission—Number of commissioners; appointment; chairman

* * * *

(i) The Commission may perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions.

* * * *

§ 203. Schedules of charges; filing with Commission; changes in schedules; overcharges and rebates; penalty for violations

(a) Every common carrier, except connecting carriers, shall, within such reasonable time as the Commission shall desiginate, file with the Commission and print and keep open for public inspection schedules showing all charges for itself and its connecting carriers for interstate and foreign wire or radio communication between the different points on its own system, and between points on its own system and points on the system of its connecting carriers or points on the system of any other carrier subject to this chapter when a through route has been established, whether such charges are joint or separate, and showing the classifications, practices, and regulations affecting such charges. Such schedules shall contain such other information, and be printed in such form, and be posted and kept open for public inspection in such places, as the Commission may by regulation require, and each such schedule shall give notice of its effective date; and such common carrier shall furnish such schedules to each of its connecting carriers, and such connecting carriers shall keep such schedules open for inspection in such public places as the Commission may require.

(b) (1) No change shall be made in the charges, classifications, regulations, or practices which have been so filed and published except after ninety days notice to the Commission and to the public, which shall be published in such form and contain such information as the Commission may by regulations prescribe.

(2) The Commission may, in its discretion and for good cause shown, modify any requirement made by or under the authority of this section either in particular instances or by general order applicable to special circumstances or conditions except that the Commission may not require the notice period specified in paragraph (1) to be more than ninety days.

(c) No carrier, unless otherwise provided by or under authority of this chapter, shall engage or participate in such communication unless schedules have been filed and published in accordance with the provisions of this chapter and with the regulations made thereunder; and no carrier shall (1) charge, demand, collect, or receive a greater or less or different compensation for such communication, or for any service in connection therewith, between the points named in any such schedule than the charges specified in the schedule then in effect, or (2) refund or remit by any means or device any portion of the charges so specified, or (3) extend to any person any privileges or facilities in such communication, or employ or enforce any classifications, regulations, or practices affecting such charges, except as specified in such schedule.

(d) The Commission may reject and refuse to file any schedule entered for filing which does not provide and give lawful notice of its effective date. Any schedule so rejected by the Commission shall be void and its use shall be unlawful.

(e) In case of failure or refusal on the part of any carrier to comply with the provisions of this section or

of any regulation or order made by the Commission thereunder, such carrier shall forfeit to the United States the sum of $500 for each such offense, and $25 for each and every day of the continuance of such offense.

§ 204. Hearings on new charges; suspension pending hearing; refunds

(a) Whenever there is filed with the Commission any new or revised charge, classification, regulation, or practice, the Commission may either upon complaint or upon its own initiative without complaint, upon reasonable notice, enter upon a hearing concerning the lawfulness thereof; and pending such hearing and the decision thereon the Commission, upon delivering to the carrier or carriers affected thereby a statement in writing of its reasons for such suspension, may suspend the operation of such charge, classification, regulation, or practice, in whole or in part but not for a longer period than five months beyond the time when it would otherwise go into effect; and after full hearing the Commission may make such order with reference thereto as would be proper in a proceeding initiated after such charge, classification, regulation, or practice had become effective. If the proceeding has not been concluded and an order made within the period of the suspension, the proposed new or revised charge, classification, regulation, or practice shall go into effect at the end of such period; but in case of a proposed charge for a new service or an increased charge, the Commission may by order require the interested carrier or carriers to keep accurate account of all amounts received by reason of such charge for a new service or increased charge, specifying by whom and in whose behalf such amounts are paid, and upon completion of the hearing and decision may by further order require the interested carriers to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such charge for a new service or in-

creased charges as by its decision shall be found not justified. At any hearing involving a charge increased, or sought to be increased, the burden of proof to show that the increased charge, or proposed charge, is just and reasonable shall be upon the carrier, and the Commission shall give to the hearing and decision of such questions preference over all other questions pending before it and decide the same as speedily as possible.

(b) Notwithstanding the provisions of subsection (a) of this section, the Commission may allow part of a charge, classification, regulation, or practice to go into effect, based upon a written showing by the carrier or carriers affected, and an opportunity for written comment thereon by affected persons, that such partial authorization is just, fair, and reasonable. Additionally, or in combination with a partial authorization, the commission, upon a similar showing, may allow all or part of a charge, classification, regulation, or practice to go into effect on a temporary basis pending further order of the Commission. Authorizations of temporary new or increased charges may include an accounting order of the type provided for in subsection (a) of this section.

§ 205. Commission authorized to prescribe just and reasonable charges; penalties for violaitons

(a) Whenever, after full opportunity for hearing, upon a complaint or under an order for investigation and hearing made by the Commission on its own initiative, the Commission shall be of opinion that any charge, classification, regulation, or practice of any carrier or carriers is or will be in violation of any of the provisions of this chapter, the Commission is authorized and empowered to determine and prescribe what will be the just and reasonable charge or the maximum or minimum or maximum and minimum, charge or charges to be thereafter observed, and what classification, regulation or practice is or will be just, fair, and reasonable, to be

thereafter followed, and to make an order that the carrier or carriers shall cease and desist from such violation to the extent that the Commission finds that the same does or will exist, and shall not thereafter publish, demand, or collect any charge other than the charge so prescribed, or in excess of the maximum or less than the minimum so prescribed, as the case may be, and shall adopt the classification and shall conform to and observe the regulation or practice so prescribed.

(b) Any carrier, any officer, representative, or agent of a carrier, or any receiver, trustee, lessee, or agent of either of them, who knowingly fails or neglects to obey any order made under the provisions of this section shall forfeit to the United States the sum of $1,000 for each offense. Every distinct violation shall be a separate offense, and in case of continuing violation each day shall be deemed a separate offense.

Supreme Court, U.S.
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CLERK

No. 88-1249 and 88-1250

In the Supreme Court of the United States

OCTOBER TERM, 1988

SOUTHERN BELL TELEPHONE AND TELEGRAPH COMPANY, ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

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QUESTION PRESENTED

Whether the Commission has authority under the Communications Act of 1934, 47 U.S.C. 151 *et seq.*, to enforce its 1976 prescription of a rate of return for 1978 rates by requiring carriers to refund, through prospective rate reductions, revenues collected in 1978 in excess of the maximum prescribed return.

TABLE OF CONTENTS

	Page
Opinions below	1
Jurisdiction	1
Statement	2
Argument	14
Conclusion	30

TABLE OF AUTHORITIES

Cases:

Arizona Grocery Co. v. *Atchison, Topeka & Santa Fe R.R.*, 284 U.S. 370 (1932) 8, 16
AT & T v. *FCC*, 487 F.2d 865 (2d Cir. 1973) 2
AT & T, 57 F.C.C.2d 960 (1976) 4, 6
AT & T, 58 F.C.C.2d 1 (1976) 5, 6, 24, 25
AT & T, 38 F.C.C.2d 213 (1972) 6
AT & T, 86 F.C.C.2d 221 (1981) aff'd, 707 F.2d 610 (D.C. Cir. 1983) 22
Bebchick v. *PUC*, 313 F.2d 187 (D.C. Cir.), cert. denied, 373 U.S. 913 (1963) 25
Capital Cities Cable, Inc. v. *Crisp*, 467 U.S. 691 (1984) .. 3
City of New York v. *FCC*, 108 S. Ct. 1637 (1988) 3
FPC v. *Louisiana Power & Light Co.*, 406 U.S. 621 (1972) 3
FPC v. *Natural Gas Pipeline Co.*, 315 U.S. 575 (1942) ... 16
FPC v. *Tennessee Gas Transmission Co.*, 371 U.S. 145 (1962) 4, 18, 21, 25
FPC v. *Texaco, Inc.*, 417 U.S. 380 (1974) 17
General Telephone Co. v. *United States*, 449 F.2d 846 (5th Cir. 1971) 18
ICC v. *Brotherhood of Locomotive Engineers*, 107 S. Ct. 2360 (1987) 27-28
Las Cruces TV Cable v. *FCC*, 645 F.2d 1041 (D.C. Cir. 1981) 9
Massachusetts Trustees v. *United States*, 377 U.S. 235 (1964) 28
Nader v. *FCC*, 520 F.2d 182 (D.C. Cir. 1975) ..... *passim*

Cases—Continued: Page

North American Telecomm. Ass'n v. *FCC*, 772 F.2d 1282 (7th Cir. 1985) 3, 17
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SEC v. *Chenery Corp.*, 332 U.S. 194 (1947) 27, 28
United States v. *FCC*, 707 F.2d 610 (D.C. Cir. 1983) 4, 22
Wisconsin v. *FPC*, 373 U.S. 294 (1963) 18-19

Statutes:

Communications Act of 1934, 47 U.S. 151 *et seq.* 2
§ 4(i), 47 U.S.C. 154(i) ..... *passim*
§ 201(b), 47 U.S.C. 201(b) 2
§ 202(a), 47 U.S.C. 202(a) 2
§ 203, 47 U.S.C. 203 ..... 17, 20
§ 204, 47 U.S.C. 204 ..... *passim*
§ 204(a), 47 U.S.C. 204(a) 3, 24
§ 205, 47 U.S.C. 205 ..... *passim*
§ 205(a), 47 U.S.C. 205(a) 2, 16
§ 206, 47 U.S.C. 206 18
§§ 206-209, 47 U.S.C. 206-209 ..... 12, 22
§ 209, 47 U.S.C. 209 18
§ 408, 47 U.S.C. 408 ..... 2, 16
Natural Gas Act, 15 U.S.C. 717 *et seq.*
15 U.S.C. 717*o* 3
15 U.S.C. 717d(a) 16
41 Stat. 488-491 22-23

Miscellaneous:

Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers (CC Docket No. 84-800 Phase III), FCC 86-354 (released Aug. 25, 1986) 22
FCC News Rep. No. DC-1379, *Commission Adopts Incentive Regulation for Dominant Carriers* (Mar. 16, 1989) 28
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Miscellaneous—Continued: Page

H.R. Rep. No. 193, 73d Cong., 1st Sess. (1933) 23

Inquiry Concerning AT&T's Earnings on Interstate and Foreign Services During 1978, 75 F.C.C.2d 412 (1979) 6, 7, 26

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BRIEF FOR THE FEDERAL RESPONDENTS IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals (Pet. App. 1a-39a)[1] is reported at 826 F.2d 1101. The initial order of the Federal Communications Commission (Pet. App. 40a-72a) is reported at 102 F.C.C.2d 52. The Commission orders denying reconsideration (Pet. App. 86a-120a, 121a-129a) are not reported.

JURISDICTION

The judgment of the court of appeals (Pet. App. 130a-132a) was entered on August 21, 1987. A petition for

[1] "Pet. App." refers to the appendix to the petition for a writ of certiorari in No. 88-1250.

rehearing was denied on November 2, 1988. Pet. App. 133a-140a. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATEMENT

1. Under the Communications Act of 1934, 47 U.S.C. 151 *et seq.* (Act), the Federal Communications Commission (FCC or Commission) is responsible for ensuring that the regulations, classifications, charges, and practices of carriers of interstate and foreign communications are just, reasonable, and non-discriminatory. 47 U.S.C. 201(b), 202(a). The Act provides the Commission with a number of regulatory tools to carry out that broadly defined responsibility. In particular, under Section 205, the Commission may investigate a carrier's rates and practices; and if, after a hearing, it finds that a rate or practice is or will be unlawful under the Act, the Commission may prescribe just and reasonable rates or practices "to be thereafter observed." 47 U.S.C. 205(a). Such a prescription is binding on the carrier, which "shall not thereafter publish, demand, or collect any charge other than the charge so prescribed, or in excess of the maximum * * * so prescribed * * * and shall conform to and observe the regulation or practice so prescribed." *Ibid.* Any such prescription is binding for the time specified in the Commission's order or until the order is superseded. 47 U.S.C. 408. See *Permian Basin Area Rate Cases,* 390 U.S. 747, 779 (1968) (no "limitations of time" imposed by statute on agency prescription order); *AT & T* v. *FCC,* 487 F.2d 865, 880 (2d Cir. 1973).

The Commission has additional powers to investigate the lawfulness of proposed new practices or charges under Section 204 of the Act. It may suspend the effectiveness of such practices or rates for up to five months pending its investigation. In the case (as is involved here) of a proposed

increased rate, if the investigation is not completed after the specified period of suspension, the Commission may allow the rate to take effect but require the carrier to keep an accounting of the amounts it collects under the rate. At the end of the investigation, the Commission may order the carrier "to refund, with interest, to the persons in whose behalf such amounts were paid, such portion of such charge * * * as * * * shall be found not justified." 47 U.S.C. 204(a).

Supplementing those and other express provisions of the Act, Section 4(i) authorizes the agency to "perform any and all acts, make such rules and regulations, and issue such orders, not inconsistent with this chapter, as may be necessary in the execution of its functions." 47 U.S.C. 154(i). That provision is a "necessary and proper clause." *North American Telecomm. Ass'n* v. *FCC,* 772 F.2d 1282, 1292 (7th Cir. 1985). It gives the FCC a flexible and wide-ranging power to take steps to implement Congress' broadly worded directives defining the Commission's rate regulation and other responsibilities.[2]

In 1972, the Commission, under its Section 4(i) authority to take necessary and proper measures to implement its Section 205 power to prescribe just and reasonable rates and practices, asserted the authority to prescribe the rate of return a carrier may earn. See Pet.

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[2] See, *e.g., City of New York* v. *FCC,* 108 S. Ct. 1637, 1643 (1988); *Capital Cities Cable, Inc.* v. *Crisp,* 467 U.S. 691, 700 (1984); *North American Telecomm. Ass'n* v. *FCC,* 772 F.2d at 1292-1293. Cf. *FPC* v. *Louisiana Power & Light Co.*, 406 U.S. 621, 642 (1972) (Natural Gas Act, 15 U.S.C. 717*o*) ("the Commission must possess broad powers to devise effective means to meet these responsibilities"); *Permian Basin Area Rate Cases,* 390 U.S. 747, 774-777 & n.40 (1968) (same).

App. 4a-5a.[3] That authority was upheld by the D.C. Circuit and has not been questioned elsewhere. *Nader* v. *FCC,* 520 F.2d 182, 203-204 (D.C. Cir. 1975). See *United States* v. *FCC,* 707 F.2d 610 (D.C. Cir. 1983). The D.C. Circuit ruled that such rate of return prescriptions are "necessary for the Commission to carry out its [ratemaking] functions in an expeditious manner." *Nader* v. *FCC,* 520 F.2d at 204. Cf. *FPC* v. *Tennessee Gas Transmission Co.,* 371 U.S. 145, 150-155 (1962) (upholding FPC's order of refund based on determination of the reasonable rate of return, prior to any determination of how the costs of service should be allocated). The court also explained that a rate of return prescription, like any other Section 205 prescription, is binding: it limits the utility prospectively to the prescribed return. *Nader* v. *FCC,* 520 F.2d at 201. The court further pointed out that, although such a prescription protects the carrier from "the possibility of refunds on the ground that [the] * * * [prescribed] return [i]s too high, the Commission retains full latitude to order refunds on all other grounds." *Id.* at 205 n.25.

2. a. This case involves the FCC's enforcement of a rate of return prescription. In 1976, after a lengthy hearing, the Commission prescribed a rate of return of 9.5 percent for AT & T and its then-affiliated operating companies. *AT & T,* 57 F.C.C.2d 960 (Feb. 5, 1976). Although 9.5

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[3] The rate of return is one of the components of the formula that is typically used to determine the revenue requirements, and hence the rates, of a regulated company. The rate of return may be defined as "the amount of money a utility earns, over and above operating expenses, depreciation expense, and taxes, expressed as a percentage of the legally established net valuation of utility property, the rate base." P. Garfield & W. Lovejoy, *Public Utility Economics* 116 (1964). Under one common form of rate regulation, a regulated carrier is authorized to set rates that will recover its legitimate expenses (including depreciation and taxes) plus a reasonable return (the rate of return) on its rate base (the net investment of property).

percent was the prescribed return, the Commission afforded the company a .5 percent margin of error, specifying that "AT&T should be permitted 'a level or range of interstate earnings not to exceed 10%' " and that the Commission would not require "any downward adjustment of AT&T's overall interstate rates provided its overall rate of return does not exceed 10 percent." *Id.* at 973.

AT & T filed rates that it stated were designed to achieve the prescribed rate of return of 9.5 percent. Without finding that the rates were just and reasonable, the Commission, exercising its Section 204 power, suspended the rates for one day and then permitted them to go into effect on February 29, 1976, subject to an accounting order for possible refund. *AT & T*, 58 F.C.C.2d 1, 4 (Feb. 26, 1976).[4] AT & T was required to keep an accounting, not customer-by-customer, but "by service classes and subclasses, in the aggregate." *Id.* at 5.

In requiring the accounting and retaining the power to compel a refund, the Commission stated that its recent prescription of the rate of return had left unresolved "numerous other issues * * * which control the individual rates which AT & T may charge for specific services and the expenses and rate base upon which the rate of return is calculated." 58 F.C.C.2d at 4. The Commission expressly listed other components of a full determination of a just and reasonable rate—the correctness and legitimacy of AT & T's claimed investments, cash expenses, and non-cash expenses such as depreciation, and whether "the rates proposed or in effect actually * * * produce a fair rate of return." *Ibid.* (quoting *Nader* v. *FCC*, 520 F.2d at 204). Of course, without resolving those issues, it was not possible to determine whether the actual rates charged by AT & T

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[4] The Commission limited the suspension to a single day in order to avoid subverting AT & T's "opportunity to earn the fair rate of return which we have prescribed." 58 F.C.C.2d at 4.

would produce the rate of return that the Commission prescribed.[5]

b. After the rates had become effective and had been collected for almost three years, the data contained in monthly reports that AT & T filed with the Commission indicated that AT & T's earnings in 1978 had exceeded not only the authorized return of 9.5 percent but also the established buffer of an additional .5 percent. Accordingly, in October 1979, the Commission issued a notice of inquiry to determine what action it should take in response to the apparent violation of its rate of return prescription. *Inquiry Concerning AT&T's Earnings on Interstate and Foreign Services During 1978,* 75 F.C.C.2d 412 (1979).[6] In requesting comments on what action it should take, including comments on the option of ordering a refund, the notice of inquiry twice pointed to the suspension and accounting order that allowed the 1978 rates to take effect (*id.* at 414 n.5, 415 n.6) and stated that the notice was

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[5] Petitioners fail to mention that the 1978 rates (filed in 1976) took effect subject to an accounting order. Petitioners in No. 88-1249 state that "there was no relevant accounting order." 88-1249 Pet. 6. Petitioners in No. 88-1250 state that AT & T "filed rates * * * and the FCC allowed them to become effective" (88-1250 Pet. 6); they also state that "[n]o suspension, investigation and accounting order was entered in connection with Bell's rate of return when it filed its rates in 1976" (*id.* at 14 n.19).

[6] The 1976 rate of return prescription of 9.5 percent was in effect for five years. During that time, AT & T's overall rate of return was 9.69 percent. Moreover, in four of the five years—all of the years in which the prescription was in effect for all 12 months—AT & T's rate of return exceeded 9.5 percent. Pet. App. 14a-15a. In 1976, AT & T's earnings were 9.25 percent; but its authorized rate of return during the first two months of that year was only 8.5 percent. *AT & T,* 38 F.C.C.2d 213, 245 (1972). The Commission's order prescribing a 9.5 percent rate of return was released on February 5, 1976, and the new rates implementing that prescription became effective on February 29. *AT & T,* 57 F.C.C.2d at 960; *AT & T,* 58 F.C.C.2d at 1, 4, 5.

issued pursuant to Sections 4(i), 204, and 205 of the Act (among others) (75 F.C.C.2d at 416).

c. After considering the comments filed by industry and consumer groups, the Commission determined that AT & T had earned a rate of return for its interstate and foreign services of 10.22 percent during 1978. Pet. App. 46a-51a. Noting that there were insuperable practical obstacles (especially after the AT & T divestiture) to distributing individually calculated refunds to each of the millions of AT & T's 1978 ratepayers, many of whom might no longer be in existence or identifiable, the Commission chose instead a class-wide refund mechanism consistent with the non-individualized accounting that it had required for the filing of the rates at issue: the Commission required downward adjustments of 1985 rates, to be apportioned among AT & T and the divested Bell Operating Companies (BOCs). *Id.* at 53a-54a. The Commission thus ordered AT & T and the BOCs to pay back the 1978 earnings in excess of a 10 percent rate of return by means of "a temporary discount upon interstate services for a period that is sufficient to reduce carrier revenues by the amount that is to be restored to interstate ratepayers." *Id.* at 52a.

The Commission rejected the suggestion that the 1976 rate of return prescription had not been intended to operate as a limit on AT & T's earnings. The Commission observed that the plain language of the prescription order had provided that AT & T's earnings were " 'not to exceed 10 percent.' " Pet. App. 56a. Relying on Section 205, the Commission noted that a "carrier is under an affirmative duty to revise its rates to conform to [an] outstanding prescription order." Pet. App. 58a. It further observed that "[t]he proper procedure for a carrier who contends that an outstanding order is improper is to petition the Commission to modify that order," which AT & T did not do. *Id.* at 56a-57a (footnote omitted).

The Commission also rejected the argument that it had accepted the rates when they were filed in 1976, that those rates had become lawful, and that the Commission could not later declare them unlawful. Pet. App. 57a-58a. The Commission pointed out that it had never found that the 1978 charges were just and reasonable and, indeed, had found some charges for particular services that were in effect in 1978 to be unlawful in other proceedings. *Id.* at 57a. It elaborated on that conclusion in a lengthy Appendix B to its decision (*id.* at 73a-85a), which noted that the rates in effect in 1978 had been suspended and subjected to an accounting order issued in reliance on Section 204 and Section 4(i) (Pet. App. 73a, 85a).

Finally, the Commission rejected the contention that it lacked authority to order a refund because Section 205 of the Communications Act did not specifically authorize refunds of revenues in excess of a prescribed rate of return. The Commission pointed simply to its Section 4(i) authority. It concluded that the court in *Nader* v. *FCC,* 520 F.2d at 204-205 & n.25, had recognized that "the power to order refunds is inherent in the Commission's prescription authority." Pet. App. 59a.

d. On reconsideration, the Commission reaffirmed its authority to adopt the restitution mechanism. See Pet. App. 101a-105a. The Commission rejected the contention that the order constituted retroactive ratemaking. *Id.* at 101a-104a. It noted that the restitution order "involved the enforcement of an outstanding order that was by its terms prospective" (*i.e.,* the 1976 rate of return prescription); and it pointed out again that it had never "authorized" the 1978 rates (*id.* at 102a n.55 (citing Appendix B of its initial order)). The Commission observed that *Arizona Grocery Co.* v. *Atchison, Topeka & Santa Fe R.R.,* 284 U.S. 370 (1932) (*Arizona Grocery*), and other ratemaking retroactivity decisions relied on by petitioners, involved "circumstances in which the regulatory body actually set the

specific price, or 'charge', that was to be paid by the user of the regulated entity's service"; here, by contrast, the Commission set the rate of return, not the rate, and the carrier itself set the charges subject to the constraints imposed by the rate of return prescription. Pet. App. 103a n.55, 103a-104a.

The Commission also reaffirmed its rejection of the argument that a rate of return prescription was not intended to be binding but merely to set a goal for future ratemaking. Pet. App. 104a-105a. The Commission cited a D.C. Circuit decision that had upheld a refund decision under Section 204 involving rates that, when filed, had not been found just and reasonable (*Las Cruces TV Cable* v. *FCC,* 645 F.2d 1041 (1981)) and again cited Appendix B of its initial decision, which showed that AT & T's 1978 rates were in a similar position. Pet. App. 104a n.60. The Commission also explained that the particular rate of return prescription order involved here clearly had restricted the amount that AT&T could earn on its interstate operations. While AT & T was required in the first instance to file rates "targeted" to earn 9.5 percent, the order set a "clearly stated upper bound" of 10 percent. *Id.* at 104a-105a. See also *id.* at 109a-111a (citing *Nader* v. *FCC* and FCC decisions since 1972, Commission rejects suggestion that treating rate of return prescription as setting upper bound was a new policy). Finally, the Commission reiterated that the restitution mechanism it chose was amply justified—in preference to a refund of excess charges to each individual 1978 customer—as "the least expensive, and most efficient, approach to effecting restitution." *Id.* at 111a-112a.[7] The Commission subsequently denied petitions seeking further reconsideration or clarification. *Id.* at 121a-129a.

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[7] The Commission noted its concern "that direct credits to each customer's bill would be more expensive than providing a

3. The court of appeals affirmed. Pet. App. 1a-20a. The court first ruled that a prescription of a rate of return does not merely require that carriers target their rates to try to achieve that return, as petitioners contended, but also declares that any higher return "is unlawful and *shall not occur.*" *Id.* at 9a. The court explained that petitioners' view of the Commission's Section 205 authority focused only "on carriers' subjective efforts, not on future events," and that the Commission's objective view is a more reasonable construction of the statute: "The Commission's chief concern in issuing prescriptions is protecting just and reasonable rates, not policing carriers' states of mind." Pet. App. 9a. Indeed, the court pointed out that, in *Nader* v. *FCC*, it had made clear that a rate of return prescription is no less binding than a rate prescription: the order at issue in *Nader* had " 'the prospective effect of a prescription, thus *limiting the utility to that return.' Nader, supra,* 520 F.2d at 202 (emphasis added)." Pet. App. 10a. Hence, while AT & T was required to target its rates to achieve the prescribed 9.5 percent rate of return, it was also forbidden actually to earn more than the 10 percent rate that included the .5 percent buffer, and was free to file adjusted rates as necessary to avoid that result.

Turning to the question of remedy, the court of appeals, after stating without explanation that Section 204 does not apply to this case, held that the Commission had the authority under Section 4(i) of the Communications Act to enforce its rate of return prescription by requiring the re-

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discount on future services," citing, among other things, comments that AT & T had filed. Pet. App. 112a & n.86.

The Commission pointed to the same set of practical difficulties in explaining why it chose the mechanism of a future rate reduction rather than basing a restitution plan on the complex series of service-by-service accounting orders for specific services described in Appendix B of the initial decision. Pet. App. 112a n.87.

fund of AT & T's excessive earnings. Pet. App. 10a-15a.[8] That provision, the court noted (*id.* at 12a), is a "wide-ranging source of authority" that expressly authorizes measures " 'necessary in the execution of [the Commission's] functions.' " Here, the court pointed out: "In a strictly technical sense, the Commission's choice of remedy was absolutely necessary; without the reductions, the carriers in fact would not be limited to a return of 10% and the prescription would be violated." *Ibid.* In any event, the court said, "the Commission enjoys significant discretion to choose among a range of reasonable remedies, including refunds." *Ibid.* While the Commission might have taken other corrective action, the court concluded (*ibid.*), "the measure it adopted in this case was appropriate and reasonable."

The court rejected the suggestion that the refund order constituted retroactive ratemaking. The court explained simply: "There was not retroactive ratemaking here, because the carriers' obligations were set prospectively in 1976, when the Commission forbade AT & T from earning more than 10%." Pet. App. 13a. In requiring refunds for 1978 earnings in excess of the prescribed return, the court added, the Commission's order "merely recognized that the prior prescription had been violated and imposed a remedy for the violation." *Ibid.* The court agreed with the observation of the Commission in its brief that " '[t]he carriers are being required merely to give up what they never should have collected in light of the rate of return prescription.' " *Ibid.*

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[8] The court pointed out that "the order does not impose a refund in the classic sense of restitution" because "the reductions will accrue to the benefit of a different customer base from the base that contributed to AT&T's excessive earnings." Pet. App. 11a. The court held, however, that even if the remedy were properly characterized as a refund, "the order was well within the agency's statutory authority." *Ibid.*

The court also ruled that the Commission's order did not distort the regulatory balance between the interests of ratepayers and carriers. Pet. App. 13a-15a. First, the court pointed out that the 1976 rate of return prescription provided a measure of protection to carriers, as it protected them against any subsequent claim for refund on the ground that the rate of return was too high. *Id.* at 13a-14a (quoting *Nader* v. *FCC*, 520 F.2d at 205 n.25). Hence, if AT & T's cost of capital in the market had plunged below the prescribed rate of return, so that AT & T could offer an above-market return to attract capital, the Commission could not have sought a refund on that ground, but would have had to initiate a new proceeding to set a new, prospectively applicable rate of return. *Id.* at 14a.

Second, the court observed that, although the Commission required refunds for excessive rates of return but had not provided for carriers to be compensated for shortfalls in the rate of return, that asymmetry was not improper: carriers "are entitled only to earn an overall reasonable return," and they have an ample opportunity to do so. Pet. App. 14a. Thus, the court noted that carriers may at any time file new rates that are designed to achieve an adequate return; if a shortfall appears likely, carriers can propose an appropriate rate change. *Id.* at 14a, 15a. Indeed, in this respect, the refund/shortfall asymmetry reflects a carrier/ratepayer asymmetry: while carriers may file rate changes to protect themselves against shortfalls, ratepayers, the court explained, must rely predominantly on the Commission to protect them from unlawful charges. *Id.* at 14a.[9] Moreover, the court noted that the .5 percent buffer both in general made it easier for carriers to design rates targeted to produce more than the 9.5 percent figure but less than the 10 percent ceiling and, in this case, "more

[9] Ratepayers may also seek damages in certain circumstances pursuant to Sections 206-209 of the Act, 47 U.S.C. 206-209.

than adequately protected" AT & T's interests; during three of the five years in which the 1976 prescription was in effect, "the carrier's rates were designed precisely enough to produce a return above the ceiling but not so far above as to trigger a Commission remedy." *Id.* at 14a-15a. See note 6, *supra*. In short, the court concluded that the Commission's order did not "foster an impermissible balance between the interests of the carriers and those of the consumers." *Id.* at 13a.

Finally, the court of appeals rejected several challenges that petitioners do not renew in their petitions in this Court. Pet. App. 15a-20a. In particular, the court rejected the contention that, even if the refund order was lawful, it represented an abrupt reversal of prior policy and therefore could not be applied in the present case. The court explained that the order, far from reversing a prior policy, simpy responded to a new situation: "never before had a carrier exceeded a rate-of-return prescription." *Id.* at 16a. In any event, petitioners clearly could show no detrimental reliance on the non-enforcement of the prescription, as they conceded—indeed, insisted—that "they made every effort to comply with the prescription." *Id.* at 17a. In addition, the court of appeals rejected several of petitioners' challenges to the Commission's method of computing the carriers' liability. *Id.* at 18a-20a.

Judge Buckley dissented. Pet. App. 20a-39a. He did not argue, however, that the court erred in upholding the Commission's statutory authority to order the refund; in his view, the issue of statutory authority should not have been addressed. *Id.* at 21a. Rather, Judge Buckley would have set aside the Commission's order on the ground (not presented by petitioners in this Court) that the refund policy could not be applied to petitioners in any event because it represented an abrupt alteration of prior Commission policy. *Ibid.*

4. After the Commission issued its refund order in this case, it promulgated a general rule requiring all carriers to refund earnings they receive in excess of a previously established rate of return. In a decision rendered after the decision in the present case, the court of appeals, while reaffirming the present decision, set aside the Commission's general refund rule as arbitrary and capricious and remanded to the Commission. Pet. App. 141a-161a. Subsequently, the full court of appeals denied en banc rehearing of both cases. *Id.* at 133a-140a, 160a-166a. Judge Starr, joined by Judges Buckley and Williams, would have granted en banc review on the ground that the Commission's position, in this case as well as in the general rulemaking case, is inconsistent with the statutory scheme. *Id.* at 135a, 162a; see *id.* at 152a-159a.

ARGUMENT

The decision of the court of appeals does not warrant this Court's review. First, the court correctly held that the Commission had authority under Section 4(i) to enforce its earlier rate of return prescription by directing the carriers to pay back their excess collections; and that ruling does not conflict with any decision of this Court or of any other court of appeals.[10] Second, the court's affirmance of the Commission's order is independently justified on another ground, though one not relied on by the court of appeals—that the order in this particular case was authorized under Section 204 (in combination with Section 4(i)) of the

[10] The law in the D.C. Circuit is " 'distressingly unsettled' " (88-1250 Pet. 20, quoting Pet. App. 135a) only in the limited sense that three of the judges have expressed their disagreement with the position adopted by two panels of the circuit. That position, in upholding the refund order here, follows logically from the earlier decision in *Nader* v. *FCC*, 520 F.2d at 202-206, and is not in conflict with any other decision of the D.C. Circuit.

Communications Act. Third, the continuing importance of the issue decided in the case is uncertain; and if the issue recurs, it is more appropriately reviewed in another case—particularly, in the context of the general Commission rulemaking on the refund question, currently on remand from the court of appeals.

1. The court of appeals correctly held that the FCC acted within its Section 4(i) authority in requiring the petitioner carriers to refund, through a reduction in future rates, the revenues AT & T collected in 1978 in excess of the maximum rate of return prescribed in 1976. Rate of return prescriptions are statutorily authorized. And a refund is clearly justified as a necessary means of enforcing such prescriptions.

a. The Commission undoubtedly has the authority, under Section 4(i) in conjunction with Section 205, to prescribe rates of return for the communications carriers it regulates. Section 205 permits the Commission to prescribe just and reasonable "charges" and "practices," and Section 4(i) broadly authorizes the Commission to make rules and to issue orders that are "necessary in the execution of its functions." Prescribing a rate of return allows the Commission to settle one of the critical issues that determine the lawfulness of particular rates, freeing both carriers and the Commission to focus on the other issues, such as the validity of elements of the rate base and of particular expenses. Accordingly, the D.C. Circuit expressly affirmed the Commission's authority to prescribe rates of return in 1975, *Nader* v. *FCC*, 520 F.2d at 203-206, explaining that such prescriptions are "necessary for the Commission to carry out its [ratemaking] functions in an expeditious manner" (*id.* at 204). Such authority is well within the broad authority that this Court has frequently recognized that ratemaking agencies have " 'to make the pragmatic adjustments which may be called for

by particular circumstances.' " *Permian Basin Area Rate Cases*, 390 U.S. at 776-777 (quoting *FPC* v. *Natural Gas Pipeline Co.*, 315 U.S. 575, 586 (1942)). Such authority has been well established since 1975, and, indeed, petitioners do not openly challenge it here.

Any prescription issued under Section 205 has binding, coercive effect. Section 205 declares that a "charge" or "practice" prescribed under that provision is "to be thereafter observed"; and it further states that carriers "shall not thereafter publish, demand, or collect any charge other than the charge so prescribed, or in excess of the maximum * * * so precribed * * * and shall conform to and observe the regulation or practice so prescribed." 47 U.S.C. 205(a).[11] Prior to the 1976 prescription at issue here, moreover, *Nader* v. *FCC* made clear that a rate of return prescription had the binding effect of limiting the carrier to the prescribed rate of return (plus the buffer). 520 F.2d at 201-202. The 1976 prescription itself stated that AT & T's rate of return was " 'not to exceed' " the 10 percent enforcement-triggering ceiling. Pet. App. 6a. Hence, the court of appeals correctly held that the 1976 rate of return prescription was "no less binding" than a prescription of rates and had the " 'the force of a statute. . . . The carrier [was] bound to conform.' " *Id.* at 10a (quoting *Arizona Grocery*, 284 U.S. at 386).

An inherent and necessary corollary of the power to adopt binding rate of return prescriptions is the authority to enforce those prescriptions. This Court has often recog-

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[11] An order remains binding until superseded. See 47 U.S.C. 408 (FCC orders "shall continue in force for the period of time specified in the order or until the Commission or a court of competent jurisdiction issues a superseding order"). Cf. *Permian Basin Area Rate Cases*, 390 U.S. at 779 ("Nothing in [15 U.S.C. 717d(a)] imposes limitations of time upon the effectiveness of rate determinations issued under it; rather, the section provides that rates held to be just and reasonable are 'to be thereafter observed * * *.' ").

nized in the ratemaking context that " 'the width of administrative authority must be measured in part by the purposes for which it was conferred * * *.' " *FPC* v. *Texaco, Inc.*, 417 U.S. 380, 389 (1974), quoting *Permian Basin Area Rate Cases*, 390 U.S. at 776. Section 4(i), which serves as a "necessary and proper" clause (*North American Telecomm. Ass'n* v. *FCC*, 772 F.2d at 1292-1293), is by its terms designed to provide flexibility to the Commission in carrying out its statutory responsibilities. The enforcement of a prescription that is authorized under Section 205 is at the core of the enforcement authority that Section 4(i) grants the Commission. Again, petitioners do not expressly dispute that the Commission must be able to enforce its prescriptions.

As the court of appeals recognized, once the validity of rate of return prescriptions and the Commission's authority to enforce such prescriptions are accepted, the power to require refunds is readily justified as a tool to enforce a rate of return prescription. A refund is the most obvious means of ensuring that a directive establishing a maximum rate of return is not violated; indeed, a backward-looking remedial mechanism such as a refund is unavoidable where the prescription at issue is of a rate of return, because not until revenues are actually collected can it be determined whether the carrier actually exceeded the prescribed rate of return.[12] Thus, the court of appeals in

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[12] If the rates themselves are prescribed, a refund mechanism is necessary if the carrier actually charges in excess of the prescribed rates. Pet. App. 13a. Similarly, if the rates are allowed to go into effect but not found lawful by the Commission in advance, then a refund may be a necessary means of enforcing a subsequent determination of lawful rates. See 47 U.S.C. 204 (expressly authorizing refunds). If a carrier in fact charges the rates found lawful and prescribed by the Commission in advance, then there is no inherent justification for a backward-looking review of actual collections. Accordingly, because carriers' rates must be published and adhered to (47 U.S.C. 203), the

this case stated that the Commission's choice of the refund remedy, in "a strictly technical sense," was "absolutely necessary," because otherwise "the carriers in fact would not be limited to a return of 10% and the prescription would be violated." Pet. App. 12a.[13]

In any event, the FCC "enjoys significant discretion to choose among a range of reasonable remedies." Pet. App. 12a; *Nader* v. *FCC*, 520 F.2d at 203; see *General Telephone Co.* v. *United States*, 449 F.2d 846, 865 (5th Cir. 1971) (courts "must give deference to the choice of remedy selected by the agency," which should be upheld if it is "reasonably calculated to effectuate the policies of the Communications Act"). Refunds are well within that range. Indeed, compensatory remedies are expressly provided for in other sections of the Communications Act, 47 U.S.C. 204, 206, 209, and a refund is a well-established remedial device in utility regulation generally. See, *e.g.*, *Permian Basin Area Rate Cases*, 390 U.S. at 825-828; *FPC* v. *Tennessee Gas Transmission Co.*, 371 U.S. at 150-155.[14]

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issue of refunds, outside the Section 204 context, became significant only after the Commission began in 1972 to prescribe carriers' rates of return rather than only their rates.

[13] Petitioners in No. 88-1249 (at 11 n.15) state that the Commission's remedy "was to order that the rates on file be retargeted to the prescribed return." That argument ignores the fact that the Commission already had issued an order—the rate of return prescription—that had been violated. Nothing in the statutory scheme supports the suggestion that the only enforcement tool for violation of an agency order is to issue another order that may itself be violated.

[14] It would be inconsistent with the longstanding approach to the interpretation of the broadly worded ratemaking statutes—indeed, it would stand that approach on its head—to suggest that the Commission, when choosing a means of enforcing a form of order that is authorized by, though not specifically mentioned, in the statute, is forbidden to adopt remedies that are specifically provided for elsewhere in the statute. Cf. *Wisconsin* v. *FPC*, 373 U.S. 294, 309

b. Contrary to petitioners' contention, the requirement that they refund earnings in excess of the prescribed maximum return in no way violates the rule against retroactive ratemaking. The reason is simple: as the court of appeals explained, there was no retroactive ratemaking here, because the obligation being enforced was set prospectively in 1976 when the FCC issued its rate of return prescription. Pet. App. 13a. The refund order merely imposed a remedy for the carriers' violation in 1978 of the duty that was imposed in 1976. *Ibid.*

For that reason, petitioners' assertion that the decision below conflicts with numerous decisions concerning retroactive ratemaking is incorrect. See 88-1249 Pet. 13-18; 88-1250 Pet. 11-16. None of those decisions involved the situation that is at issue in this case—agency action enforcing an existing, prospectively defined prescription, let alone a rate of return prescription. Nothing in those decisions forbids a ratemaking agency's use of a refund to enforce, in a practical, administratively convenient manner, a valid, prospective agency order.[15]

Similarly, the Commission's choice of remedy to enforce its rate of return prescription does not disturb the balance between the interests of carriers and customers that Congress has established in the Communications Act. Of course, the Commission order must be judged on the basis of the provisions of the statute, not on the basis of an

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(1963) ("to declare that a particular method of rate regulation is so sanctified as to make it highly unlikely that any other method could be sustained would be wholly out of keeping with this Court's consistent and clearly articulated approach to the question of the Commission's power to regulate rates").

[15] The prospective nature of the FCC's action here is underscored by the fact that it did not order refunds by the independent (*i.e.*, non-AT & T) telephone companies, because the agency had not prescribed a rate of return limitation for those companies. Pet. App. 117a-118a & n.108.

idealized structure that imposes one particular vision of alleged "symmetry" that is not expressed in the statute itself. As we have shown, the refund order is authorized by the statute. In any event, as the court of appeals concluded, the Commission's order properly respects the statutory balance of carrier and ratepayer protection. Pet. App. 15a.

First, the Commission permitted AT & T a margin of .5 percent above the prescribed just and reasonable level of 9.5 percent, recognizing the imprecision of ratemaking and providing the carriers an incentive for efficiency. Only when—and to the extent that—AT & T exceeded both the 9.5 percent prescription and the .5 percent margin did the Commission require a refund. AT & T thus had ample room to set rates that were designed to achieve the authorized rate of return without fear of refunds caused by minor forecasting errors.[16]

Second, AT & T had an adequate opportunity to seek relief from anticipated shortfalls. If it appeared likely that the rates established by AT & T would be inadequate to achieve the prescribed return, AT & T could have filed tariff revisions. See 47 U.S.C. 203. On a proper showing, the Commission would have allowed such revisions to become effective promptly. As the court of appeals noted, AT & T presumably had every incentive to seek such revisions. Pet. App. 18a. And the Commission, having set a

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[16] In the general rulemaking proceeding, the court of appeals invalidated the Commission's general refund rule, explaining that the present case was different because here the Commission provided " 'ample protection for the carriers' interests.' " Pet. App. 149a-151a. The court also observed that the validity of the refund rule depended critically on whether the buffer was large enough so that expected swings in earnings deviated from the authorized rate of return by no more than that amount. *Id.* at 147a n.4. For AT & T during 1976-1980, of course, that was so, with the exception of 1978.

fair rate of return, reasonably could rely on AT & T to protect itself against a shortfall.[17]

Third, AT & T was always protected against the possibility that the Commission would order a refund on the ground that the prescribed rate of return was too high. Thus, if the cost of capital had fallen in 1977—after the FCC's prescription order had become effective—so that AT & T's achieved return of 9.59 percent in that year had been far above a level reasonably necessary to attract investment, the Commission would have been foreclosed by its prescription order from requiring a refund on that basis. Pet. App. 13a-14a (citing *Nader* v. *FCC*, 520 F.2d at 205 n.25). The Commission would have had to initiate and to complete a proceeding to revise its prescription order prospectively to eliminate that protection from AT & T

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[17] The record in this case does not support a finding that AT & T failed to achieve its authorized rate of return during any period of time in which the prescription was in effect. During the five years in which the 9.5 percent prescription was in effect, AT & T's rate of return averaged 9.69 percent—well above the prescribed level. Pet. App. 14a. Petitioners allege that there was a shortfall in 1976, but their sole support for that contention is that AT & T's earnings in that year were 9.25 percent. *E.g.*, 88-1250 Pet. 6, 7, 15-16. As noted above (note 6, *supra*), AT & T's authorized rate of return during the first two months of 1976 was only 8.5 percent. Because AT & T was not authorized to earn 9.5 percent throughout 1976, its failure to achieve a 9.5 percent return in 1976 does not establish a shortfall.

In any event, AT & T had an opportunity to earn the prescribed level (plus the margin) by filing rates and conducting its business. Customers, by contrast, had no choice but to pay the tariffed rates. It is hardly unfair to a carrier, even if a shortfall were shown, to disallow a second opportunity to achieve the prescribed level of earnings. See *FPC* v. *Tennessee Gas Transmission Co.*, 371 U.S. at 153, 150-155 (company must shoulder hazards incident to its action in filing rates, "including not only the refund of any illegal gain but also its losses where its filed rate is found to be inadequate").

and to lower its prescribed ceiling to the level justified by current conditions.[18]

Finally, the provisions of the statute are not perfectly symmetrical; indeed, they embody a distinction between carriers and ratepayers that the refund order of the Commission reflects. Pet. App. 14a. Thus, while carriers propose their own rates, and may seek increases when appropriate, ratepayers do not have a comparable power of initiation: they must generally rely on the Commission itself for protection. The refund order assists in that protection. Indeed, the Commission's order is entirely in keeping with the provisions of the statutory scheme that expressly permit recovery from a carrier for violations of a duty under the Act. *E.g.*, 47 U.S.C. 204, 206-209. In short, requiring AT & T to refund earnings it received in violation of outstanding prescription orders did not disturb the statutory balance of interests, but rather vindicated that balance.[19]

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[18] The Commission in 1981 prescribed a rate of return for AT & T of 12.75 percent, with a buffer of .25 percent. *AT & T*, 86 F.C.C.2d 221 (1981), aff'd, *United States* v. *FCC*, 707 F.2d 610 (D.C. Cir. 1983). Subsequently, economic circumstances changed significantly in a direction indicating that the rate of return (and thus the rates) should be lower. AT & T, however, was permitted to earn a rate of return of 13 percent under the 1981 prescription order until the FCC superseded that order with a new one. The Commission did not do so until 1986. *Authorized Rates of Return for the Interstate Services of AT&T Communications and Exchange Telephone Carriers* (CC Docket No. 84-800 Phase III), FCC 86-354 (released Aug. 25, 1986).

[19] Judge Starr, in his concurrence in the case concerning the Commission's general rulemaking on refunds, argued (Pet. App. 157a-158a) that the 1933 amendment of Section 15a of the Interstate Commerce Act (ICA), just prior to Congress's enactment of the Communications Act of 1934, shows that recapture of recoveries in excess of a prescribed rate of return is inconsistent with congressional intent behind the 1934 Act. But, even aside from the danger of relying heavily on a different statutory scheme for an industry with a different

2. The court of appeals' holding affirming the Commission's refund order in this particular case is also correct on a ground not adopted by the court of appeals. Petitioners acknowledge, as Section 204 expressly states, that the Commission has authority to require carrier refunds of excess charges if those charges were suspended, allowed to take effect pending an investigation, and subjected to an accounting order. 88-1249 Pet. 4; 88-1250 Pet. 13 n.19, 16. Contrary to petitioners' suggestion, however (see note 5, *supra*), that is precisely what the Commission did with respect to the AT & T rates that are at issue in this case. Accordingly, Section 204 (in conjunction with Section 4(i)) independently supports the Commission's refund order and the court of appeals' judgment. While this Court's review of the court of appeals' holding is not for that reason precluded, the existence of an independent ground supporting the judgment counsels against review.

a. The rates that resulted in excessive revenues in 1978 were set forth in tariff revisions filed by AT & T on Jan-

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history and different problems, the ICA amendment does not have the suggested significance. The provision that Congress replaced (a) established a single fair rate of return for all railroads in the country or in a particular designated group, based on the aggregate value of those railroads' property, and (b) required each railroad then to place into certain contingency reserves any earnings that exceeded that rate of return, regardless of the railroad's individual circumstance. See 41 Stat. 488-491. The provision did not set a carrier-specific rate of return and then require disgorgement of earnings that exceeded that rate. The House Report (H.R. Rep. No. 193, 73d Cong., 1st Sess. 27-30 (1933)), in explaining why the provision should be repealed, focused principally on the provision's grouping together of all railroads and the fluctuating conditions of individual railroads. Only one remark (quoted by Judge Starr (Pet. App. 158a)) concerns the incongruity of permitting carriers to earn more than they ought to earn and recapturing the excess, and that remark must be read in context, recognizing that the rate of return maximum at issue was not carrier-specific.

uary 19, 1976, to implement the Commission's rate of return prescription. *AT & T*, 58 F.C.C.2d 1. Exercising its authority under Section 204(a), the Commission suspended those tariff revisions for one day and set them for investigation. 58 F.C.C.2d at 4-5. The Commission required AT & T to "maintain an accounting of the revenues derived under these revised tariffs, for possible refund upon resolution of the lawfulness thereof." *Id.* at 4.[20]

The Commission had decided on the rate of return component of a just and reasonable rate, but it set for investigation numerous other issues that had to be resolved before the rate itself could be determined—*e.g.*, investments, cash expenses, and non-cash expenses. 58 F.C.C.2d at 4. Hence, as the order expressly noted, and contrary to petitioners' suggestions (see note 5, *supra*), the question whether the proposed rates actually would produce the fair rate of return that the Commission had prescribed was still open and part of the investigation. *Ibid.* The Commission cited Sections 204, 205, and 4(i) as sources of its authority to suspend, investigate, and require an accounting in this case. 58 F.C.C.2d at 5. The 1978 rates, therefore, were subject to refund under Section 204 to the extent they produced an actual rate of return that was unlawful (under the rate of return prescription) and, hence, was "not justified" (47 U.S.C. 204(a)).

The 1984 order directing the refund of such unjustified revenues was issued by the Commission while the 1976 accounting order, as well as various other accounting orders applicable to AT & T's 1978 rates, were still in effect. See Pet. App. 73a-85a (initial order, Appendix B). And, although the order directed the refund of the excess through a future rate reduction, it was a proper exercise of

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[20] See also Pet. App. 81a-93a (initial order, Appendix B) (pointing out that several other accounting orders with respect to AT & T's interstate services were in effect during 1978).

the Commission's Section 204 authority. Thus, the refund was "to the persons in whose behalf such amounts were paid" (47 U.S.C. 204), considered collectively—namely, to the (ever-changing) class of customers. Such an application of Section 204's refund authority is well within the Commission's Section 4(i) authority to make its powers effective, for as the Commission itself explained based in part on AT & T's comments (Pet. App. 53a-54a, 111a-112a), there would be insuperable obstacles to an individualized refund plan applicable to the customer base from years earlier. Plainly, Section 4(i) authorizes the Commission to give effect to Section 204's refund authorization without adopting a self-defeating plan that would waste a large part of the refund in administrative expenses (or a plan that imposed those expenses, in addition to the refund, on the carrier). Indeed, the accounting order imposed on AT & T itself required only class-wide accounting for this very reason (58 F.C.C.2d at 4-5)—and AT & T, of course, did not object—yet no individualized refund is possible based only on class-wide accounting.[21]

b. Although the court of appeals stated that Section 204 did not apply in this case (Pet. App. 12a), the court gave no explanation. For the reasons we have set out, the court's statement is incorrect: Section 204 supports the Commission's ruling in this case. And, although the Commission did not expressly rest its 1984 order on Section 204, there is no barrier to upholding the ruling on that basis.

Contrary to petitioners' suggestion (88-1250 Pet. 14 n.19), never in this proceeding has the Commission "disclaim[ed]" reliance on Section 204. Tellingly, peti-

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[21] Although large-scale refunds are rare, this is hardly a revolutionary refund mechanism in ratemaking. See, *e.g.*, *FPC* v. *Tennessee Gas Transmission Co.*, 371 U.S. at 154-155 & n.9; *Bebchick* v. *PUC*, 318 F.2d 187 (D.C. Cir.), cert. denied, 373 U.S. 913 (1963).

tioners cite no such disclaimer. Indeed, the Commission did not expressly claim exclusive reliance on Section 205 in conjunction with Section 4(i). See Pet. App. 59a. And the fact that the rates at issue were subject to an accounting order under Section 204 was repeatedly relied on at all stages of the present proceeding.

Thus, after AT & T had reported that its earnings in 1978 had exceeded a 10 percent rate of return, a petition by several citizens groups in July 1979 urged the Commission to require a refund, pointing out that AT & T's tariff filing had been subjected to an accounting order. See Pet. App. 40a n.1, 67a. The 1979 notice of inquiry that led to the refund order described the 1976 accounting order and noted that it had contemplated the possibility of refunds (75 F.C.C.2d at 415 & n.6), undertook to act on the citizens groups' petition for enforcement of the accounting order (*id.* at 414 n.5), and cited Section 204 as one of the statutory provisions that were relevant to its inquiry (75 F.C.C.2d at 416-417). In the 1984 order requiring petitioners to disgorge the excessive 1978 earnings, the Commission again referred to the citizens groups' petition for enforcement of the accounting order (Pet. App. 40a n.1) and explicitly granted that petition "to the extent stated in the rulings and procedures that have been adopted herein" (*id.* at 59a). In the same order, in rejecting the "retroactivity" argument that the rates at issue had previously become lawful, the Commission relied centrally on the fact that the 1978 rates had never been accepted as lawful, referring for elaboration to Appendix B, which explained that the rates were subject to numerous accounting orders, including the 1976 accounting order adopted under Section 204. *Id.* at 57a (referring to *id.* at 73a-85a (Appendix B)).[22]

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[22] The Commission stated in its reconsideration decision that it had not relied on "the accounting orders that are discussed in Appendix B of the *Restitution Decision* in formulating the restitution mechanism."

In its reconsideration order, the Commission again cited Appendix B in rejecting both the retroactivity argument and the argument that the rate of return prescription did not have binding effect. *Id.* at 102a n.55, 104a n.60.

In defending its order in the court of appeals, the Commission's brief did not expressly rely on Section 204. Nor did it disclaim reliance on that provision or claim exclusive reliance on Section 205.[23] At oral argument, moreover, the Commission, while acknowledging that this was not the agency's primary rationale for its action, contended "that the Commission did in fact exercise its section 204 powers here by suspending the rates, by setting up an accounting order, and that the accounting order remained valid in 1978 and that this is from that perspective a very traditional rate refund." Transcript of oral argument (Oct. 30, 1986), at 35-38.

In these circumstances, the refund order of the Commission may properly be upheld under Section 204 (in conjunction with Section 4(i)). To be sure, under *SEC* v. *Chenery Corp.*, 332 U.S. 194 (1947), a court may not uphold an agency ruling on any basis that was not relied on by the agency and that would require the court to substitute its own discretionary judgment for that of the agency. See *ICC* v. *Brotherhood of Locomotive*

Pet. App. 112a n.87. As we have noted, however (see note 7, *supra*), that statement merely explained why the Commission was adopting a discount in rates for the future instead of a customer refund plan based on the series of accounting orders described in Appendix B. It was not a disclaimer of reliance on Section 204.

[23] The brief (at 4-5 n.4) noted that the rates at issue were subject to an accounting order. It also stated (at 28), however, that "[i]f the Commission were to accept the position of the carriers in this case that it had no refund power except under Section 204 of the Act, the carriers would be free to ignore not just this rate of return prescription, but any prescription." To the extent that that statement overlooks the existence of a Section 204 accounting order in this case, it is mistaken.

Engineers, 107 S. Ct. 2360, 2368 (1987). But, in addition to the significant reliance actually placed on Section 204 by the Commission here, the *Chenery* principle does not preclude upholding the Commission refund order in this case under Section 204. If there is a valid statutory basis for an agency decision, the decision should be upheld on that basis—even if the agency relied on an incorrect statutory basis—if it is clear that the agency would have made exactly the same decision had it not relied on the incorrect statutory authority. See *Massachusetts Trustees* v. *United States,* 377 U.S. 235, 246-247 (1964). Here, it is beyond doubt that the Commission refund order would be the same under Section 204 or Section 205, and no discretionary element of the decision would be affected by which precise statutory basis supported the result. Plainly, the Commission would not abandon the objective of recouping AT & T's excessive 1978 earnings if it had to rely on Section 204, which does, after all, speak expressly of refunds. Accordingly, there is an alternative ground to support the court of appeals' judgment.

3. Even aside from the correctness of the court of appeals' holding and the existence of an alternative ground to support the judgment, this case does not merit review. First, the continuing significance of the question of refunds to enforce rate of return prescriptions is at present uncertain. The Commission recently adopted a system of "price caps" derived from current rates to replace the scheme of rate of return regulation for AT & T, and it has proposed a similar system for local exchange telephone companies. See FCC News Report No. DC-1379, *Commission Adopts Incentive Regulation for Dominant Carriers,* (Mar. 16, 1989). Such a system would eliminate or reduce substantially the Commission's primary reliance on rate of return prescriptions as a means of ratemaking, at least for AT & T. To that extent, it would effectively moot the refund issue.

If, on the other hand, the Commission pursues a policy of enforcing rate of return prescriptions through refunds (without a Section 204 accounting order), then there will be a better vehicle for reviewing that policy—one that does not involve a clear Section 204 basis for the policy. Indeed, the Commission is currently considering what steps to take on remand from the court of appeals' decision (Pet. App. 141a-159a) setting aside its general rule establishing procedures for the implementation of such a policy. If the Commission promulgates a new rule, a challenge to such a rule would provide a more suitable case for review of the refund question, as it would involve a more complete record on pertinent issues (such as the proper relation between rate of return excesses and shortfalls).

In short, although we believe that the refund issue, having been correctly resolved by the court of appeals, does not warrant this Court's review, there will be more appropriate occasions to review the question if it proves to be of continuing importance. Nor is there any equitable imperative for review of this particular case. In addition to the fact that the Section 204 accounting order put AT & T on ample notice of the possibility of a refund and independently supports the ruling, the present case merely involves the disgorgement of revenues that petitioners had no right to receive in the first place without violating the outstanding prescription order.

CONCLUSION

The petitions for a writ of certiorari should be denied.

Respectfully submitted.

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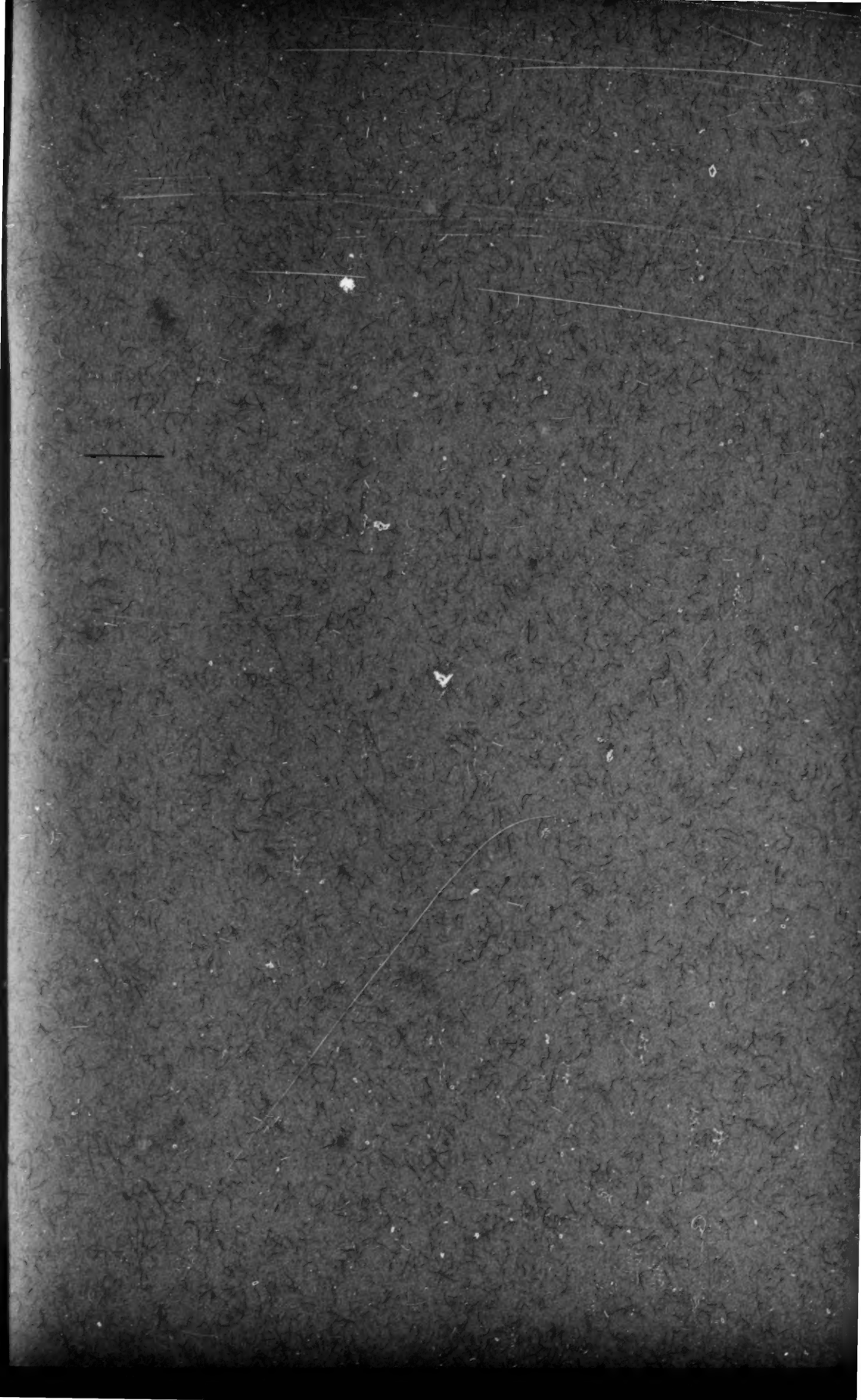

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In the Supreme Court of the United States

OCTOBER TERM, 1988

SOUTHERN BELL TELEPHONE & TELEGRAPH CO., ET AL.,
PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

NEW ENGLAND TELEPHONE AND
TELEGRAPH COMPANY, ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

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*ON PETITIONS FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE DISTRICT OF COLUMBIA CIRCUIT*

SUPPLEMENTAL MEMORANDUM FOR THE FEDERAL RESPONDENTS

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In the Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-1249

SOUTHERN BELL TELEPHONE & TELEGRAPH CO., ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

No. 88-1250

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, ET AL., PETITIONERS

v.

FEDERAL COMMUNICATIONS COMMISSION, ET AL.

ON PETITIONS FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE DISTRICT OF COLUMBIA CIRCUIT

SUPPLEMENTAL MEMORANDUM FOR THE FEDERAL RESPONDENTS

In its amicus brief in support of petitioners, the Communications Satellite Corp. (COMSAT) correctly observes (at 4) that in 1988 the Federal Communications Commis-

sion ordered COMSAT to refund amounts collected in excess of a previously prescribed rate of return (*COMSAT*, 3 F.C.C. Rcd 2643 (1988)) and that the Commission there relied on the court of appeals' ruling in the present case to reject the claim that the refund order was beyond the Commission's statutory authority (*id.* at 2645). That Commission decision is currently on review in the D.C. Circuit, which has deferred briefing pending the disposition of the petitions in these cases. We file this brief supplemental memorandum in response to COMSAT's amicus submission, since we had overlooked the *COMSAT* case in preparing our brief in opposition to the petitions for a writ of certiorari in these cases.

Notwithstanding the Commission's reliance in *COMSAT* on the ruling at issue here, the pendency of the *COMSAT* decision in the court of appeals does not undermine our submission that the continuing importance of the present ruling is insufficient to warrant review. First, besides *COMSAT*, there is no other outstanding decision raising the refund issue decided by the court of appeals here. Second, in *COMSAT* itself, as in the present cases, the Commission ordered refunds only with respect to rates that took effect subject to investigation and were made subject to an accounting order under Section 204.* See 3 F.C.C. Rcd at 2644, 2645-2647; *COMSAT*, 2 F.C.C. Rcd 3706, 3708 (1987) (proposing refund order). Third, COMSAT's appeal from the Commission's *COMSAT* decision may well raise other issues that might make it unnecessary for the court of appeals to consider the Commission's refund

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**COMSAT*, CC No. 80-634, Mem. Op. & Order (released Aug. 2, 1984) (allowing tariff changes to take effect subject to investigation with issues to be designated in subsequent order, citing Section 204); *COMSAT*, CC No. 86-634, Mem. Op. & Order (released Nov. 8, 1985) (designating issues and requiring accounting under Section 204(a)).

authority at all. Thus, the question presented by petitioners here—the Commission's refund authority outside the Section 204 context—might not be or have to be resolved by the court of appeals on review of the *COMSAT* decision, and there is no other pending case raising the issue.

Accordingly, for the reasons set forth in our brief in opposition, the present petitions should be denied.

Respectfully submitted.

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OCTOBER TERM, 1988

SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY, SOUTH CENTRAL BELL TELEPHONE COMPANY, PACIFIC BELL, NEVADA BELL, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY OF MARYLAND, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY OF VIRGINIA, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY OF WEST VIRGINIA, THE BELL TELEPHONE COMPANY OF PENNSYLVANIA, NEW JERSEY BELL TELEPHONE COMPANY, THE DIAMOND STATE TELEPHONE COMPANY, AND SOUTHWESTERN BELL TELEPHONE COMPANY,

Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,

Respondents.

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
REPLY	1
I. The FCC Did Not and Could Not Rely on Section 204 of the Communications Act	2
II. The Question Presented Is of Continuing Significance	5
III. The FCC May Enforce Its Prescriptions, But, Absent an Accounting Order, Not by Refunds	6
CONCLUSION	8

TABLE OF AUTHORITIES

CASES: Page

City of Piqua v. FERC, 610 F.2d 950 (D.C. Cir. 1979) 7
Massachusetts Trustees v. United States, 377 U.S. 235 (1964) 3
Nader v. FCC, 520 F.2d 182 (D.C. Cir. 1975) 6
SEC v. Chenery Corp., 318 U.S. 80 (1943) 3

ADMINISTRATIVE DECISIONS:

American Telephone & Telegraph Co., 58 F.C.C.2d 1 (1976) 4
Memorandum Opinion and Order, *Annual 1988 Access Tariff Filings*, CC Docket No. 88-1, Phase I, 3 F.C.C. Rcd 2043 (1988) 5
Order Designating Issues for Investigation, *Annual 1988 Access Tariff Filings*, CC Docket No. 88-1, Phase II, 3 F.C.C. Rcd 3103 (1988) 5
Memorandum Opinion and Order, *Annual 1988 Access Tariff Filings*, CC Docket No. 88-1, Phase II, FCC 88-420, 4 F.C.C. Rcd —— (rel. Dec. 27, 1988) 5
Notice of Inquiry, *AT&T's Earnings on Interstate and Foreign Services During 1978*, 75 F.C.C.2d 412 (1979) 2
Memorandum Opinion and Order, *Communications Satellite Corp.*, 3 F.C.C. Rcd 2643 (1988) 5

STATUTES:

Communications Act of 1934
Section 4(i), 47 U.S.C. § 154(i) 6
Section 204, 47 U.S.C. § 204 ..... 2, 3, 4, 5
Section 205, 47 U.S.C. § 205 ..... 2, 7

IN THE

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SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY, SOUTH CENTRAL BELL TELEPHONE COMPANY, PACIFIC BELL, NEVADA BELL, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY OF MARYLAND, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY OF VIRGINIA, THE CHESAPEAKE & POTOMAC TELEPHONE COMPANY OF WEST VIRGINIA, THE BELL TELEPHONE COMPANY OF PENNSYLVANIA, NEW JERSEY BELL TELEPHONE COMPANY, THE DIAMOND STATE TELEPHONE COMPANY, AND SOUTHWESTERN BELL TELEPHONE COMPANY,

Petitioners,

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FEDERAL COMMUNICATIONS COMMISSION AND THE UNITED STATES OF AMERICA,

Respondents.

PETITIONERS' REPLY BRIEF

Apparently fearful that the Court will not accept the basis for the decisions below, respondents seek to deflect the Court's attention by claiming a basis for those decisions that was not advanced below and is legally unsupportable in any case. Respondents also attempt to evade review by claiming that the continuing significance of this case is uncertain, even though the FCC recently issued another order relying on the power challenged here.

Notwithstanding respondents' assertions of the FCC's general power to enforce its orders, the specific remedy of refunds to enforce a rate of return prescription exceeds Communications Act limitations on the FCC's powers. Rather than allow the FCC's statutory excess to escape scrutiny, this Court should grant a writ to review the decision below.

I. The FCC Did Not and Could Not Rely on Section 204 of the Communications Act.

Respondents now argue that the FCC's authority under Section 204 of the Communications Act [1] supports the judgment below independently of Section 205 [2] and that the existence of this separate ground counsels against review. To be sure, in the notice that started the agency inquiry leading to the orders upheld below, the FCC did raise for consideration its Section 204 powers, among others.[3] In the orders resulting from that initial inquiry and upheld below, however, the FCC did not rely on Section 204.[4] It did not even mention that provision in connection with the basis for its action.

Nor did the FCC's brief below rely on Section 204 or even suggest that provision supported its action. Indeed, the FCC's brief concedes that the agency could not and was not relying on Section 204.[5] Only when it came to

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[1] 47 U.S.C. § 204.

[2] 47 U.S.C. § 205.

[3] Notice of Inquiry, *AT&T's Earnings on Interstate and Foreign Services During 1978*, 75 F.C.C.2d 412, 416 (1979).

[4] *See* Pet. App. at 65a-68a; 109a-113a. References are to the Appendix in No. 88-1249.

[5] *See* Brief of Respondent FCC at 28, stating that "[i]f the Commission were to accept the position of the carriers in this case that it has no refund power except under Section 204 of the Act, the carriers would be free to ignore not just this rate of return prescription, but any prescription." In other words, the agency asserted the need for power under Section 205 because it believed that Sec-

oral argument, after briefs were filed and the issues joined, did agency counsel suggest that Section 204 was an alternative ground for the FCC's decision. The court below, however, properly rejected this tack, stating that Section 204 "does not apply to the circumstances of this case." [6] "The decision of a *lower court* . . . must be affirmed if the result is correct, 'although the lower court relied upon a wrong ground or gave a wrong reason,'" but "[t]he grounds upon which an *administrative order* must be judged are those upon which the record discloses that its action was based." *SEC v. Chenery Corp.*, 318 U.S. 80, 87-88 (1943) (emphasis added).[7]

Even if the FCC had actually relied on Section 204 in its decisions below, which it did not, its reliance would have been unlawful. Although the FCC had suspended AT&T's 1976 rate filing and imposed an accounting order pending investigation, the issues that the FCC designated for investigation in connection with that accounting order—the only issues upon which a refund could later

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tion 204 was not available to it. Respondents here dismiss this concession as a mistaken oversight of Section 204's applicability. Opp. at 27 n.23. This oversight, whether or not it really was mistaken, may explain why the FCC did not rely on Section 204, but it does not change the fact that the FCC did not rely on that provision, despite respondents' labored suggestions now to the contrary.

[6] Pet. App. at 13a.

[7] Respondents' reliance (Opp. at 28) on *Massachusetts Trustees v. United States*, 377 U.S. 235 (1964), is misplaced. There is no indication here that the FCC was uncertain about the source of the power it claims (*compare id.* at 246), and it is doubtful that the FCC really mistook the statutory provisions on which, until now, it has consistently based its position (*compare id.* at 248). Indeed, the FCC continues here to defend its actions under those provisions. Moreover, here, unlike in *Massachusetts Trustees*, the dispute is not merely over a sum of money. Rather, the controversy here involves a fundamental question of agency power, with ramifications not only for other proceedings before the FCC, but also for proceedings before agencies governed by statutes like the Communications Act.

be ordered—involved matters of rate structure and cost allocation.[8] They had nothing to do with the basis for the refunds ordered here, namely, whether the proposed rates were designed to achieve the prescribed return.[9] There were no questions, for example, about the levels of cost or demand that AT&T had projected for its services. Quite to the contrary, the FCC stated that it could not "find the economic material filed in support of the tariff revisions inadequate or erroneous." [10] None of the matters designated for investigation in 1976, therefore, would have supported the refund ordered in 1984. Having failed to suspend the 1976 rates for investigation on rate of return grounds, the FCC could not and, not surprisingly, until now did not rely on Section 204 to order refunds.

Although the FCC may now claim Section 204 as the basis for its action, that will not change the basis for the ruling below, which sanctions agency action in excess of statutory authority and to the detriment of the careful balance of ratepayer and carrier interests struck by the Communications Act. Nothing, therefore, precludes the FCC in the future from relying on the decision below and proceeding outside Section 204, contrary to petitioners' statutorily protected interests. Indeed, the FCC did so as recently as this past December.[11] Thus, whatever the justification now given for the FCC's action, this Court should reject respondents' attempt to shelter the result below and should grant review here.

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[8] Under Section 204, the FCC may suspend rates and impose an accounting order pending a hearing on the rates only "upon delivering to the . . . carriers affected thereby a statement in writing of its reasons for such suspension." 47 U.S.C. § 204.

[9] *See American Tel. & Tel. Co.*, 58 F.C.C.2d 1, 2-3 (1976).

[10] *Id.* at 3.

[11] *See* discussion, *infra*, p. 5.

II. The Question Presented Is of Continuing Significance.

Respondents claim that a new approach to testing the reasonableness of carrier rates, which has been adopted for AT&T and proposed for exchange carriers, "would eliminate or reduce substantially the Commission's primary reliance on rate of return prescriptions . . . , at least for AT&T." Opp. at 28. This claim is hardly a ringing renunciation of the unlawful conduct for which petitioners seek review. The new approach has so far only been adopted for AT&T, and it is not clear that it will be adopted for exchange carriers or, if adopted, what form it will take. It is also evident, from the qualifications in respondents' claim here, that the FCC will continue to use rate of return prescriptions in significant respects.

Indeed, the FCC has recently asserted refund power beyond the scope of Section 204 in connection with allegedly excessive exchange carrier access charges [12] and over earnings by COMSAT.[13] Respondents even suggest that the FCC may still pursue a general policy of enforcing rate of return prescriptions through refunds (Opp. at 29) but that the Court should wait until then to review the refund matter. The question, however, is squarely presented now. Nothing is to be gained by deferring the matter to another day, while the FCC con-

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[12] Memorandum Opinion and Order, *Annual 1988 Access Tariff Filings*, CC Docket No. 88-1, Phase II, FCC 88-420, 4 F.C.C. Rcd —— (rel. Dec. 27, 1988). Indeed, unlike the agency proceedings below, in the access charge proceeding, refunds were ordered without any accounting order whatsoever anywhere in the proceeding. *See* Memorandum Opinion and Order, *Annual 1988 Access Tariff Filings*, CC Docket No. 88-1, Phase I, 3 F.C.C. Rcd 2043, 2044 (1988); Order Designating Issues for Investigation, *Annual 1988 Access Tariff Filings*, CC Docket No. 88-1, Phase II, 3 F.C.C. Rcd 3103, 3106 (1988).

[13] Memorandum Opinion and Order, *Communications Satellite Corp.*, 3 F.C.C. Rcd 2643 (1988).

tinues to transgress the Communications Act by using the power at issue.

III. The FCC May Enforce Its Prescriptions, But, Absent an Accounting Order, Not by Refunds.

The thrust of respondents' defense of the agency action upheld below is that refunds are a "necessary means of enforcing [return] prescriptions." [14] According to respondents, "once the validity of rate of return prescriptions and the Commission's authority to enforce such prescriptions are accepted, the power to require refunds is readily justified as a tool to enforce a rate of return prescription." [15] The question here, however, is whether, notwithstanding the FCC's power generally to enforce its orders, specific limitations contained in the Communcations Act's rate regulation scheme permit the particular manner of enforcement asserted. Claiming that refunds are a lawful enforcement tool because they are necessary to or inherent in the concept of a rate of return prescription only avoids that question.[16]

Although the 1975 *Nader* decision did establish that the FCC could prescribe a rate of return,[17] the court there did not undertake to rule on the specific ways in which such a prescription could prospectively operate or be enforced —the issue presented here. In particular, the court was not required to decide, nor did it decide, whether a prescription could limit returns not only by requiring the filing of properly targeted rates, or by requiring new

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[14] Opp. at 15.

[15] *Id.* at 17.

[16] Section 4(i) of the Communications Act, 47 U.S.C. § 154(i), upon which respondents ultimately rely for the FCC's authority, requires that orders issued pursuant to that provision be "not inconsistent with" the Act.

[17] *Nader v. FCC*, 520 F.2d 182 (D.C. Cir. 1975).

rates to be filed when existing rates get out of line, but also by imposing refunds of the returns actually achieved.

The rate regulation scheme of the Communications Act, however, precludes enforcement of a rate of return prescription through refunds, absent an appropriate accounting order. Requiring refunds in order to enforce a return prescription would be to impose, in respondents' own words, "a backward-looking remedial mechanism" (Opp. at 17), contrary to the Section 205 requirement that the FCC only order rate actions "to be thereafter observed." This remedy is the essence of the retroactive ratemaking that the Communications Act and other federal regulatory acts prohibit, whether the remedial purpose is to return excess earnings or recover a shortfall.[18]

Under the regulatory scheme of all these acts, carriers as well as ratepayers run the risk that rates will miss the mark, producing deficient as well as excess earnings. Any corrective must be prospective—"thereafter observed." Under respondents' scheme, however, ratepayers run no risk and are guaranteed, through refunds, that there will be no excess earnings, while carriers must absorb shortfalls. If any enforcement is necessary here, therefore, it is enforcement of the Communications Act's regulatory scheme. This Court should review the decision below for that purpose.

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[18] *See, e.g., City of Piqua v. FERC*, 610 F.2d 950, 954 (D.C. Cir. 1979) ("The retroactive ratemaking rule . . . bars utility refunds for past excessive rates, or the Commission's retroactive substitution of an unreasonably high or low rate with a just and reasonable rate").

CONCLUSION

For the foregoing reasons, petitioners' request for a writ of certiorari should be granted.

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IN THE

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OCTOBER TERM, 1988

SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
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v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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MOTION FOR LEAVE TO FILE AND RESPONSE OF AMICUS CURIAE COMMUNICATIONS SATELLITE CORPORATION TO RESPONDENTS' SUPPLEMENTAL MEMORANDUM

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1988

No. 88-1249

SOUTHERN BELL TELEPHONE & TELEGRAPH COMPANY, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

No. 88-1250

NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
Petitioners,

v.

FEDERAL COMMUNICATIONS COMMISSION, *et al.*,
Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

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MOTION FOR LEAVE TO FILE RESPONSE OF AMICUS CURIAE COMMUNICATIONS SATELLITE CORPORATION TO RESPONDENTS' SUPPLEMENTAL MEMORANDUM

Communications Satellite Corporation ("COMSAT") respectfully moves for leave to file the attached pleading.

On April 3, 1989, COMSAT filed a brief as *amicus curiae* in support of the above-captioned petitions for writ of certiorari, and the federal government respondents filed their brief in opposition. Several days later, the federal respondents filed a supplemental memorandum responding to certain arguments made by COMSAT in its *amicus curiae* brief. That supplemental memorandum was not received by COMSAT or the petitioners until Friday, April 7th.

Upon reviewing this supplemental response, COMSAT concluded that it creates an erroneous impression about the issues raised in COMSAT's *amicus curiae* brief. The Supreme Court rules make no provision, however, for *amicus curiae* to respond to such a supplemental pleading. COMSAT asked the New England Telephone petitioners to file the attached pleading pursuant to Supreme Court Rule 22.6, but they declined to do so, although they do not oppose the filing of this pleading. Accordingly, COMSAT respectfully requests leave to file the attached response to the federal respondents' supplemental memorandum.

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RESPONSE OF AMICUS CURIAE COMMUNICATIONS SATELLITE CORPORATION TO RESPONDENTS' SUPPLEMENTAL MEMORANDUM

In their supplemental memorandum, the federal respondents argue that the pendency of the *COMSAT* rate

case [1] does not undermine their previous assertion that "the continuing importance of the present ruling is insufficient to warrant review" (Supp. Mem. at 2). Some of the stated assumptions upon which that argument rests are not valid.

First, while it is technically accurate to say that there is "no other outstanding decision raising the refund issue decided by the court of appeals," we pointed out in our papers that the Commission has continued to exercise its newly asserted statutory authority to require refunds even though it did not rely upon Section 204 of the Communications Act.[2]

Second, it is true that in *COMSAT*, as in the present case, the Commission imposed an accounting order. But even assuming for present purposes that the accounting order in *COMSAT* was valid,[3] it cannot properly be used in that case or in the present case to achieve the result sought by the Commission. The purpose of an accounting order under Section 204 is to enable an accounting at the end of the investigation of rates placed into effect during the investigation.[4] The salient point, however, is that the focus of the investigation is on whether the rates were excessive *when filed*. In other words, the agency is to determine whether the carrier included all of its

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[1] *Communications Satellite Corporation*, 3 FCC Rcd 2643, *appeal docketed*, No. 88-1243 (D.C. Cir. March 28, 1988).

[2] Brief of Communications Satellite Corporation as Amicus Curiae in Support of Petitioners at 4 n.5.

[3] COMSAT argued before the Commission and would press on appeal its view that, under the express terms of Section 204, an accounting order cannot be imposed when, as in the *COMSAT* case, the new tariffs reflected decreased rather than increased charges, and the new tariffs were not suspended.

[4] New England Telephone and Telegraph Company, *et al.*, Petitioners' Reply Brief at 6.

legitimate costs (and only the legitimate costs) under the rules or regulations then applicable and whether the other estimates upon which the rates were based were reasonable when made. It is quite a different matter to determine, based on subsequent developments, whether the estimates were in actuality borne out.

In the *COMSAT* case, as in the present case, the Commission did not dispute the reasonableness of the estimates upon which the filed rates were premised. Rather, it concluded after the fact that the rates were excessive because they produced earnings greater than had been reasonably estimated. That is the kind of retroactive ratemaking which the cases roundly condemn. This is why the present case clearly warrants exercise of the Court's certiorari review.

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NEW ENGLAND TELEPHONE AND TELEGRAPH COMPANY, *et al.*,
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Respondents.

On Petition for a Writ of Certiorari to the United States Court of Appeals for the District of Columbia Circuit

BRIEF OF COMMUNICATIONS SATELLITE CORPORATION AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

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TABLE OF CONTENTS

	Page
TABLE OF AUTHORITIES	ii
INTEREST OF AMICUS CURIAE	2
ARGUMENT	3
CONCLUSION	12

TABLE OF AUTHORITIES

CASES: Page

American Public Gas Association v. FPC, 567 F.2d 1016 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978) 6, 12
American Telephone and Telegraph Co. v. FCC, 487 F.2d 865 (2d Cir. 1973) 11
American Telephone and Telegraph Co. v. FCC, 836 F.2d 1386 (D.C. Cir. 1988) 4, 5, 9, 11
Arizona Grocery Co. v. Atchison, Topeka and Santa Fe Railway Co., 284 U.S. 370 (1932) 10
Arkansas Louisiana Gas Co. v. Hall, 453 U.S. 571 (1981) 12
Atlantic Refining Co. v. Public Service Commission, 360 U.S. 378 (1959) 12
Board of Public Utility Commissioners v. New York Telephone Co., 271 U.S. 23 (1926) 6
Electrical District No. 1 v. FERC, 774 F.2d 490 (D.C. Cir. 1985) 12
FPC v. Hope Natural Gas Co., 320 U.S. 591 (1944) 6
FPC v. Sierra Pacific Power Co., 350 U.S. 348 (1956) 12
Galveston Electric Co. v. City of Galveston, 258 U.S. 388 (1922) 6
Indiana & Michigan Electric Co. v. FPC, 502 F.2d 336 (D.C. Cir. 1974), *cert. denied*, 420 U.S. 946 (1975) 12
Louisiana Public Service Commission v. FCC, 476 U.S. 355 (1986) 10
MCI Telecommunications Corp. v. FCC, 561 F.2d 365 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978) 10
MCI Telecommunications Corp. v. FCC, 765 F.2d 1186 (D.C. Cir. 1985) 10
Mobil Oil Corp. v. FPC, 483 F.2d 1238 (D.C. Cir. 1973) 11
Nader v. FCC, 520 F.2d 182 (D.C. Cir. 1975) 8, 9
Public Service Commission v. FERC, No. 87-1706 (D.C. Cir. Jan. 27, 1989) 11
Sea Robin Pipeline Co. v. FERC, 795 F.2d 182 (D.C. Cir. 1986) 12

TABLE OF AUTHORITIES—Continued

Page

Washington Gas Light Co. v. Baker, 188 F.2d 11 (D.C. Cir. 1950), *cert. denied*, 340 U.S. 952 (1951) 6

ADMINISTRATIVE DECISIONS:

American Telephone and Telegraph Co., 42 F.C.C. 2d 293 (1973) 9

Annual 1988 Access Tariff Filings, CC Docket No. 88-1, Phase II, Memorandum Opinion and Order, FCC 88-420 (released Dec. 27, 1988) 4

Authorized Rates of Return for Interstate Services of AT&T Communications Exchange Telephone Carriers, 50 Fed. Reg. 41,350 (1985) (subsequent FCC history omitted), *rev'd, American Telephone and Telegraph Co. v. FCC*, 836 F.2d 1386 (D.C. Cir. 1988) 4

Communications Satellite Corp., 3 FCC Rcd 2643 (1988) 4

STATUTES:

Communications Act of 1934,

47 U.S C. § 151 *et seq.* 2

47 U.S.C. § 154(i) 5, 9, 10, 11

47 U.S.C. § 204 7

47 U.S.C. § 204(a) 4, 6, 11

47 U.S.C. § 205 ..... 7, 8, 9, 10

47 U.S.C. § 205(a) 7, 10

Communications Satellite Act of 1962,

47 U.S.C. § 701 *et seq.* 2

Federal Power Act,

16 U.S.C. § 791a *et seq.* 5

Interstate Commerce Act,

49 U.S.C. § 10101 *et seq.* 5

Natural Gas Act,

15 U.S.C. § 717 *et seq.* 5

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BRIEF OF COMMUNICATIONS SATELLITE CORPORATION AS AMICUS CURIAE IN SUPPORT OF PETITIONERS

Communications Satellite Corporation ("COMSAT") respectfully submits this brief *amicus curiae* in support of the above-captioned petitions for writ of certiorari to review a decision of the United States Court of Appeals

for the District of Columbia Circuit. The decision is reported at 826 F.2d 1101 and is reprinted in Appendix A (1a-40a) to the petition filed by Southern Bell Telephone & Telegraph Co., *et al.*, and Appendix A (1a-39a) to the petition filed by New England Telephone and Telegraph Co., *et al.* Counsel for the parties have consented to the filing of this brief.

INTEREST OF AMICUS CURIAE

COMSAT is a private satellite communications corporation established pursuant to an Act of Congress, the Communications Satellite Act of 1962, 47 U.S.C. § 701 *et seq.* By the terms of that Act, COMSAT is deemed a common carrier under the Communications Act of 1934, 47 U.S.C. § 151 *et seq.* ("the Act"). As such, COMSAT is subject to rate regulation by the Federal Communications Commission ("FCC").

In January 1988, the FCC resolved certain issues in an investigation of COMSAT's rates by ordering COMSAT to refund to its customers revenues for past periods on the ground that such revenues represented earnings in excess of those permitted under a previously prescribed rate of return. In its order, the Commission expressly relied on the decision below to conclude that it had the statutory power to order such refunds. COMSAT has petitioned for review of that order in the D.C. Circuit, where briefing has been deferred pending the disposition of the petitions for certiorari in the instant case. COMSAT thus is directly affected by the decision of which review is now sought and has a strong interest in the ultimate resolution of the issues posed. COMSAT was an *amicus curiae* before the court below.

ARGUMENT

The court of appeals' holding has far reaching implications going beyond the specific refund obligation imposed by the FCC on AT&T and the regional Bell operating companies. Moreover, that holding is in direct conflict with the governing statute and long settled precedent interpreting it and analogous statutory schemes.

I.

As recognized by the judges who dissented from the denial of rehearing *en banc* by the court below, "the fundamental issue" presented here "is of manifest importance." [1] This case does not affect only the parties involved, nor can it be reduced to a dispute over $101 million. Rather, this case has important consequences for many of the communications common carriers regulated by the FCC and for a number of other regulated utilities as well.

This case is the first in the long history of FCC ratemaking in which the FCC has sought to order refunds for past periods without adhering to the specific provisions of its enabling statute.[2] The importance of this case is underscored by the fact that since the FCC's decision in this case, it has on several occasions sought to extend its newly asserted statutory power. As noted by petitioners,[3] soon after the FCC imposed the refund obligation on the Bell companies for alleged past excess earnings challenged in this case, it initiated a rulemaking

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[1] Southern Bell Telephone & Telegraph Co., *et al.* Appendix ("Southern Bell App.") at 44a; New England Telephone and Telegraph Co., *et al.* Appendix ("New England App.") at 135a (Starr, J., joined by Buckley and Williams, J.J., dissenting).

[2] *See* Southern Bell Telephone & Telegraph Co., *et al.* Petition for a Writ of Certiorari ("Southern Bell Pet.") at 4-7; New England Telephone and Telegraph Co., *et al.* Petition for a Writ of Certiorari ("New England Pet.") at 10.

[3] Southern Bell Pet. at 7; New England Pet. at 8-9.

proceeding in which it ultimately adopted a rule requiring all dominant domestic common carriers to refund automatically any earnings in excess of their previously prescribed rate of return—regardless of whether the FCC had investigated the rates that ultimately produced those earnings prior to their going into effect or whether the FCC had imposed an accounting order as provided for in Section 204(a) of the Act.[4]

In January 1988, the Commission invoked the same asserted statutory power when it ordered COMSAT to refund to its customers the sum of $38.755 million for past periods based solely on a finding that this was the amount by which COMSAT had exceeded a previously prescribed rate of return. The FCC, relying on the holding of the court of appeals in the instant case, found it unnecessary even to discuss COMSAT's arguments that the Commission lacked the statutory power to take such action.[5]

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[4] *Authorized Rates of Return for Interstate Services of AT&T Communications and Exchange Telephone Carriers,* 50 Fed. Reg. 41,350 (1985) (subsequent FCC history omitted). The D.C. Circuit subsequently invalidated these rules on other grounds in *American Tel. & Tel. Co. v. FCC,* 836 F.2d 1386 (D.C. Cir. 1988) (*"Rulemaking Case"*), New England App. at 141a. However, two members of the panel in the *Rulemaking Case* stated that the decision from which certiorari is now sought had dispositively resolved the statutory question; one member of that panel disagreed, stating that the refund rule adopted by the Commission was inconsistent with the statutory scheme.

[5] *Communications Satellite Corp.,* 3 FCC Rcd 2643, 2645 (1988). As noted above, COMSAT has petitioned for review of that order, and the D.C. Circuit has deferred briefing pending resolution of this case. Since the release of the COMSAT rate order, there has been at least one other major rate investigation in which the FCC has ordered refunds for past periods even though the conditions of Section 204(a)—suspension of rates, investigation and imposition of an accounting order—had not been met. *See Annual 1988 Access Tariff Filings,* Memorandum Opinion and Order, FCC 88-420 (released Dec. 27, 1988). Petitions for reconsideration of that decision are now pending before the FCC, and it is noted here only

The FCC action sustained by the court below may have consequences that go beyond the scope of the Communications Act. As noted by petitioners,[6] the Communications Act was patterned on the Interstate Commerce Act, 49 U.S.C. § 10101 *et seq.*, which also was the model for the Federal Power Act, 16 U.S.C. § 791a *et seq.*, and the Natural Gas Act, 15 U.S.C. § 717 *et seq.* Each of these statutes reflects a carefully crafted scheme in which the ability of the regulatory agency retroactively to modify a carrier's charges is carefully circumscribed. Under none of these statutory schemes may the carrier or the regulatory agency design present or future rates to compensate for or redress the effect of events that took place in the past; instead, retroactive relief is limited to certain circumstances not present here. It is in this sense that Judge Starr noted that the instant case presents a "pivotal statutory issue cutting across agency lines." [7]

Ultimately what is at issue in this case is whether an agency may, through reliance on general provisions like Section 4(i) of the Communications Act, 47 U.S.C. § 154(i), rewrite a statute to confer new powers on itself. Judge Starr's concurring opinion in the *Rulemaking Case* squarely recognized the heart of the matter: "we must not permit those quasiautonomous creatures of the political branches to tear asunder that which the representatives of the people have seen fit to ordain and maintain for a quarter of the Nation's history." [8] We show below that this is precisely what the FCC has done.

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to show that the agency has continued to adhere to its expansive interpretation of its statutory authority.

[6] Southern Bell Pet. at 12, 13 & n.21, 16 n.25; New England Pet. at 3 n.1.

[7] Order denying suggestion for rehearing *en banc*, Southern Bell App. at 44a; New England App. at 135a (Starr, J., joined by Buckley and Williams, J.J., dissenting).

[8] *Rulemaking Case, supra* n.4, 836 F.2d at 1396, New England App. at 159a (Starr, J., concurring).

II.

The decision of the court of appeals is fundamentally erroneous because, as noted in the dissent to the denial of rehearing *en banc*, "the FCC has . . . purported to exercise a power which Congress never conferred upon it." [9] The retroactive refund power that the FCC now asserts certainly cannot be found in the statutory provisions, taken alone or in combination. Moreover, the agency's action is at odds with over fifty years of agency and judicial interpretation of this and analogous statutory schemes.

Congress set out in the Communications Act a regulatory regime that gives the FCC power to regulate rates but reflects the well established prohibition against retroactive ratemaking, with carefully circumscribed refund power.[10] Under Section 204(a), the FCC may suspend a carrier's new or revised tariff for a specified period and investigate its lawfulness.[11] If the FCC has not completed its investigation by the end of the suspension period, and the carrier puts the tariff into effect, the FCC may impose an accounting order requiring the carrier to keep accurate account of all amounts received from new or increased charges. Should the FCC ultimately determine that the charges exceed that which is just and reasonable, it may then order the carrier to refund the difference between the tariff filed and the charges ultimately approved.

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[9] Southern Bell App. at 44a; New England App. at 135a (Starr, J., joined by Buckley and Williams, J.J., dissenting).

[10] *See, e.g., FPC v. Hope Natural Gas Co.*, 320 U.S. 591, 618 (1944); *Board of Pub. Util. Comm'rs v. New York Tel. Co.*, 271 U.S. 23, 31-32 (1926); *Galveston Elec. Co. v. City of Galveston*, 258 U.S. 388, 395 (1922); *American Pub. Gas Ass'n v. FPC*, 567 F.2d 1016, 1057 (D.C. Cir. 1977), *cert. denied*, 435 U.S. 907 (1978); *Washington Gas Light Co. v. Baker*, 188 F.2d 11, 21 (D.C. Cir. 1950), *cert. denied*, 340 U.S. 952 (1951).

[11] 47 U.S.C. § 204(a).

Section 205 applies to a carrier's existing tariffs. Under that section, the FCC may investigate a carrier's charges on its own motion or upon a complaint, and if it finds that they are not just and reasonable, it may "determine and prescribe what will be the just and reasonable . . . charges to be *thereafter* observed." [12] Under Section 205, the FCC cannot impose an accounting order or subsequently order refunds with respect to the investigated rates.

The statute carefully balances the interests of carriers and their customers. A carrier initiates tariff filings, but the agency has an opportunity to review the new rates before they become effective to confirm that the carrier has filed in accordance with all pertinent requirements. The agency may suspend the new rates and begin an investigation. If the investigation extends beyond the statutorily prescribed suspension period, the carrier may put the new rates into effect, but the agency has the option of imposing an accounting order to preserve its authority to order refunds should it ultimately determine that the tariffs were not valid when filed.

Rates that go into effect without an accounting order are the only amounts that the carrier may charge and its customers must pay, with no provision for refunds or retroactive increased charges. If the carrier believes that its existing rates are producing unreasonably low earnings, it may file higher rates that are subject to the Section 204 review authority. On the other hand, if the agency, after a Section 205 investigation, determines that a carrier's existing rates are unreasonably high, it may order the carrier to lower its rates to a level then deemed reasonable. But rate changes, whether proposed by a carrier or ordered by the FCC, can only be effective on a prospective basis.

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[12] 47 U.S.C. § 205(a) (emphasis added).

The court below fails to apply the statutory provisions mandated by Congress. Basing its decision upon its expansive interpretation of the court of appeals' earlier opinion in *Nader v. Federal Communications Commission*, 520 F.2d 182 (D.C. Cir. 1975), the court reasons that if the FCC has the power to prescribe a rate of return—as *Nader* held—then it must have the power to enforce that prescription retroactively through a refund order.

The court below misreads *Nader*. The *Nader* court ruled only that the FCC could properly determine AT&T's allowed rate of return and authorize AT&T to use that rate of return in filing its rates, while the agency continued its investigation into AT&T's rate base and the other elements that go into the ratemaking process.[13] *Nader* did not purport to change the FCC's basic method of ratemaking, nor bestow any special significance on a rate of return prescription. In particular, *Nader* did not hold that a prescribed rate of return has the attributes of a prescribed rate under Section 205 of the Act; to the contrary, it explicitly stated that the "claim that a rate of return is equivalent to rates must be rejected since a rate of return is merely one component of a rate."[14]

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[13] In particular, the court stated:

> Obviously, reaching a decision on each of the components that make up a rate is a time-consuming task, especially when the Commission undertakes to reevaluate the economic principles for making these determinations. If the Commission can effectuate its decision as it adjudicates each component of the rate, the public more rapidly receives the benefit of the protection inherent in the Commission's authorization to prescribe just and reasonable charges. Therefore, we believe that the Commission's Phase I order prescribing AT&T's rate of return was in the public interest . . . .

520 F.2d at 204.

[14] *Id.* at 201. When a rate of return is prescribed, the carrier must file rates designed to achieve that return, and the FCC will scrutinize those rates to determine whether the projections are reasonable. But as New England Telephone petitioners show (Pet.

Nor did *Nader* "bring[] with it an enforcement mechanism" that authorizes the FCC to set future rates to compensate for past events;[15] again to the contrary, *Nader* reaffirmed "the cardinal principle" barring retroactive ratemaking[16]—namely, that neither a utility nor an agency may set rates to recoup past losses or refund past surpluses.

The court below recognizes that Section 205 by its terms does not confer the refund authority claimed by the FCC. However, it puts Section 205 together with Section 4(i) of the Act—which confers on the FCC a general power to perform any and all acts and make rules and regulations "not inconsistent" with the Act "as may be necessary in the execution of its functions"[17]—to uphold the refund order. The court's rationale is that since the FCC can prescribe a rate of return under Section 205, Section 4(i) authorizes it to enforce that prescrip-

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at 11), no one can be sure that the return achieved will equal or be greater or less than the prescribed return no matter how meticulous the carrier's projections. That is so because when carriers are calculating their rates, they of necessity must forecast future traffic levels along with projected costs and revenues. If the actual demand, costs and revenues are (for whatever reason) different from the estimates—which, given the inherent imprecision of estimates, will almost always be the case—the carrier's actual return will differ from the allowed rate of return upon which the carrier's tariffs were based. *See, e.g., American Tel. & Tel. Co.*, 42 F.C.C.2d 293, 300 (1973). Given that a rate of return prescription is by its nature therefore simply a prescribed goal, there is no more justification for retroactive refunds with respect to a rate filed in response to a rate of return prescription order than for such refunds with respect to an ordinary rate filing—a power the Commission does not claim to possess. Rather, the issue with respect to rate of return is the same as that for the other components of the charge —namely, whether the forecasts were reasonable when made.

[15] *Rulemaking Case, supra* n.4, 836 F.2d at 1395, New England App. at 156a (Starr, J., concurring) (emphasis in original omitted).

[16] *Nader*, 520 F.2d at 202.

[17] 47 U.S.C. § 154(i).

tion essentially by any means it chooses, including a refund order.

This reasoning is fallacious in two respects. First, a rate of return prescription is not a prescription order within the meaning of Section 205. Section 205(a) empowers the FCC to prescribe "the just and reasonable . . . *charge* or *charges* to be thereafter observed."[18] When the FCC prescribes a carrier's charge, it specifies an amount, and both the carrier and its customers know that is the amount that the carrier is to charge and the customer is to pay, and neither expects (nor can obtain) any adjustments.[19] In contrast, when the FCC prescribes a rate of return, the carrier uses that rate of return in calculating its rates, but neither it nor its customers will know whether it has achieved (or exceeded) that rate of return until after the fact. And, as has been discussed elsewhere,[20] if the carrier is to be held to its prescribed rate of return retroactively, it will virtually always be recouping shortfalls or refunding surpluses, thereby effectively eliminating the prospectivity of Section 205 from the Act.

Second, Section 4(i) cannot be used to circumvent the specific substantive provisions of the Act.[21] The specific

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[18] 47 U.S.C. § 205(a) (emphasis added).

[19] *See, e.g., Arizona Grocery Co. v. Atchison, Topeka & Santa Fe Ry. Co.*, 284 U.S. 370, 389-90 (1932).

[20] *See supra* n.14.

[21] *See Louisiana Pub. Serv. Comm'n v. FCC*, 476 U.S. 355, 370 (1986) ("we would be disinclined to favor the provision declaring a general statutory purpose, as opposed to the provision which defines the jurisdictional reach of the agency formed to implement that purpose"); *MCI Telecommunications Corp. v. FCC*, 765 F.2d 1186, 1194 (D.C. Cir. 1985) (Commission's authority cannot be released "from the tie that binds it to the text [of Title II] Congress enacted"); *MCI Telecommunications Corp. v. FCC*, 561 F.2d 365, 375 (D.C. Cir. 1977), *cert. denied*, 434 U.S. 1040 (1978);

provisions of the Communications Act discussed above reflect a deliberate decision by Congress that, except as specified in Section 204(a), which is not relevant here, ratemaking is to be prospective. Adherence to that principle is both balanced and fair: since a carrier cannot go back to its customers to make up any shortfalls, it should not have to pay them any amounts that are determined after the fact to be surpluses. It also preserves incentives for a carrier to economize: if the carrier's costs exceed its estimates, it cannot seek reimbursement from its customers, whereas if it is able to realize efficiencies, it can benefit from them at least for the period of regulatory lag. Finally, as noted by Judge Starr in his concurrence in the *Rulemaking Case*, a scheme in which carriers are required to make refunds for past surpluses "does clear violence to the values of stability and predictability that Congress so carefully enshrined in the Communications Act." [22]

In sum, an agency must follow its governing statutory scheme, remaining faithful to both its terms and intent. The court below improperly sanctions the use of the general provisions of Section 4(i) in a fashion that disrupts that scheme. Moreover, the court's decision is clearly contrary to a host of other decisions interpreting the Communications Act and related statutes applicable to other

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American Tel. & Tel. Co. v. FCC, 487 F.2d 865, 876-80 (2d Cir. 1973). *See also Public Serv. Comm'n v. FERC*, No. 87-1706, slip op. at 9-10 (D.C. Cir. Jan. 27, 1989) (" 'Section 16 [of the Natural Gas Act, the equivalent of Section 4(i) of the Communications Act], which uses a broad generality of "necessary or appropriate" that is not rooted in a function, cannot enlarge the choice of permissible procedures beyond those that may fairly be implied from the substantive sections and the functions there defined.' ") (quoting with approval *Mobil Oil Corp. v. FPC*, 483 F.2d 1238, 1257 (D.C. Cir. 1973)).

[22] *Rulemaking Case, supra* n.4, 836 F.2d at 1394, New England App. at 155a (Starr, J., concurring).

industries.[23] Such action clearly warrants exercise by this Court of its certiorari jurisdiction.

CONCLUSION

For the foregoing reasons, the petitions for a writ of certiorari should be granted.

Respectfully submitted,

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[23] Petitioners have cited many decisions from both this Court and various courts of appeals that affirm the basic tenet that current and future ratemaking should not become embroiled in making corrections " 'for excess or insufficiencies of rates charged in the past.' " Southern Bell Pet. at 9; New England Pet. at 14 (quoting *American Pub. Gas Ass'n v. FPC*, 567 F.2d at 1057). *See, e.g., Atlantic Refining Co. v. Public Serv. Comm'n*, 360 U.S. 378, 389 (1959); *Sea Robin Pipeline Co. v. FERC*, 795 F.2d 182, 184 (D.C. Cir. 1986); *Electrical Dist. No. 1 v. FERC*, 774 F.2d 490, 492 (D.C. Cir. 1985); *Indiana & Michigan Elec. Co. v. FPC*, 502 F.2d 336, 345 (D.C. Cir. 1974), *cert. denied*, 420 U.S. 946 (1975). *See also Arkansas Louisiana Gas Co. v. Hall*, 453 U.S. 571, 578 (1981); *FPC v. Sierra Pac. Power Co.*, 350 U.S. 348, 353 (1956). We do not repeat that discussion here, other than to emphasize that all of these cases are grounded upon a faithful reading of the applicable statutes, each of which parallels the Communications Act.